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ENERGY MARKET MANIPULATION AND FEDERAL ENFORCEMENT REGIMES

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

JUNE 3, 2008

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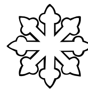

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ENERGY MARKET MANIPULATION AND FEDERAL ENFORCEMENT REGIMES

TUESDAY, JUNE 3, 2008

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 10 a.m. in room SR–253, Russell Senate Office Building, Hon. Maria Cantwell, presiding.

OPENING STATEMENT OF HON. MARIA CANTWELL, U.S. SENATOR FROM WASHINGTON

Senator CANTWELL. Good morning. I would like to welcome everyone to today's hearing on energy market manipulation and thank our distinguished witnesses for being here today: George Soros, Chairman of Soros Fund Management; Professor Michael Greenberger, University of Maryland School of Law; Gerry Ramm, President of Inland Oil, on behalf of the Petroleum Marketers Association of America; Lee Ann Watson, Deputy Director of the Division of Investigation Enforcement for the Federal Energy Regulatory Commission; and Mark Cooper, Director of Research for the Consumer Federation of America.

We are here today to examine whether today's record high oil and petroleum prices can be explained or predicted by normal market dynamics of supply-and-demand fundamentals, what connection exists between financial markets, particularly the futures market, the price at the pump that consumers are paying today, how the Federal Trade Commission's Advance Notice of Proposed Rulemaking can lead to more meaningful consumer protection, what the Federal Trade Commission's consideration should be in the area of manipulation, and what lessons the FTC can learn from other Federal agencies whose oversight of electricity and natural gas markets have encumbered manipulation in those markets. In short, we are here today to make sure that Federal agencies are doing their job in protecting consumers and policing the oil markets.

Why is this such a concern? Well, one reason is that we've seen more than a doubling of oil prices, from $60 to $135 a barrel, in just over 2 years. And that is without a major supply disruption. We also have seen manipulation of energy prices in other markets. Enron and others manipulated the western electricity markets in 2000 and 2001, and it cost consumers $40 billion. In light of that, Congress gave the Federal Energy Regulatory Commission new authority in the Energy Act of 2005. Specifically, Congress made it unlawful for any person to use or employ any manipulative or de-

ceptive devices or contrivances in connection with wholesale electricity and natural gas markets.

We are here today to hear from the FERC's deputy director of investigation enforcement on how FERC used its new authority to root out manipulation in the physical electricity and natural gas markets. To date, FERC has used its new authority to conduct 64 investigations, resulting in 14 settlements, totaling over 48 million in civil penalties. And we have seen the very same traders move from Enron to Amaranth, and American families and businesses have the same concerns that the potential of those same types of practices actually occurring in the oil markets.

In December of 2007, Congress granted the Federal Trade Commission anti-manipulation authority in that year's energy bill. Specifically, it said that it is unlawful for any person to use or employ any manipulative or deceptive device or contrivance in conjunction with the purchase or sale of crude oil, gasoline, or petroleum distillates at wholesale.

These are two laws that have been based on the Security and Exchange Act of 1935. Congress did this to provide the Federal Energy Regulatory Commission and the Federal Trade Commission with the ability to provide a clear standard by which manipulation could be based on. In fact, the Supreme Court has compared this body of law to, quote, "a judicial oak which has grown from little more than a legislative acorn."

The FTC needs to take its new anti-manipulation responsibility seriously and write a strong rule, like FERC has done, so that consumers will be protected from price manipulation. In both the natural gas and oil markets, people have seen how the futures price affects the physical prices.

Recent investigations by the Congress and the Government Accountability Office, corroborated by substantial congressional testimony from marketers and experts, make clear that tight correlation between futures and spot price, and that this is what consumers may actually be paying for energy. That is why it is so critical for the Commodities Futures Trading Commission to be an aggressive cop on the beat to fulfill its congressional mandate to protect American energy consumers from fraud, manipulation, and excessive speculation in all futures markets that trade U.S. products.

We saw Enron game the futures market to drive future energy prices higher so electricity customers would be forced to sign higher-priced long-term contracts in the physical market. We saw the same thing with Amaranth and natural gas, as a large hedge fund drove up the price, the futures price, and natural gas customers were forced to pay for even higher physical deliveries.

It is abundantly clear to me that the CFTC is not doing everything it can to protect American families and businesses from the possible oil price manipulation. Americans may be surprised to learn that the oil futures market were substantially deregulated by the CFT staff decisions that were made behind closed doors. Now, this London and Dubai loophole is keeping important U.S. energy trading in the dark, and, without proper light, it's this kind of manipulation that can happen and give manipulators free rein in energy markets.

Two weeks ago, I sent a letter to the CFTC, along with 21 of my colleagues, insisting that they reverse their "no action" policy and start policing all U.S. oil markets. I know several of my colleagues on this Committee joined me in sending this letter, including Senators Snowe, Dorgan, Kerry, Boxer, Klobuchar, and Claire McCaskill.

The CFTC's May 29 apparent response to this letter, I believe, does not go far enough. The CFTC's response is a toothless tiger. There are four things wrong with the CFTC approach:

First, there is no large speculation limits, which are critical to preventing fraud, manipulation, and excessive speculation.

Second, the CFTC will not collect the same information that it collects from other regulated exchanges, and the information will be unaudited and unverifiable.

Third, unlike any of the fully regulated exchanges, like NYMEX, there will be no enforcement mechanism.

And, fourth, the CFTC's announcement is an agreement to agree: there are actually no firm commitments, and all of these measures may not even eventually be put in place.

So, the CFTC announcement appears to be nothing more than a ruse to deflect criticism of what is a serious abdication of oversight responsibility.

We look forward to hearing a formal response to our letter insisting on the CFTC to fully regulate all energy trading of U.S. energy commodities and close the London-Dubai oil loophole. If the CFTC does not act, I am planning on introducing legislation that will force them to do so. For those of us who suffered the manipulations of Enron, we have plenty of perspective to share with the CFTC. We want you to do your job.

We expect them to police the oil markets on issues of fraud, manipulation and excessive speculation, and I hope that, today, our witnesses can illuminate these issues for the American public and for the consumers that are impacted by these record gasoline prices.

Now I'd like to turn to my colleagues to make their opening statements.

Senator Dorgan?

STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Senator Cantwell, thank you very much.

You mentioned the Enron scandal. I chaired the hearings in this Committee when Ken Lay came to that very table and took an oath and then took the Fifth Amendment. I recall those of us who were concerned about what was happening on the West Coast, raising it, time and time again, and everyone said, "Well, that's just the market. It's just the market. Don't intervene, the market's at work." Turns out to have been a criminal enterprise, at least in part, and people were fleeced out of billions of dollars.

It's time, it seems to me now to—I'm not suggesting a criminal enterprise with respect to the pricing of energy, but I am saying there's a lot of what I call "dark money" moving around here, the same origin, it seems to me, with respect to the subprime loan scandal, dark money that you couldn't see where it was and how

it was being used, and securitizing everything, putting bad loans in with good loans; it's like packing sausage with sawdust, as they used to do, and then slicing them up moving them around. The same dark money exists, in my judgment, with respect to this orgy of speculation with respect to energy markets.

Now, they say there's a free market. People talk about market forces. There's no free market here at all. You have a cartel, called OPEC, that's at the front end. You've got oil companies, bigger and stronger through mergers, that have more muscle in the marketplace. And then you have an orgy of speculation in the futures markets. There's no free market at all. We have what I think is a speculative bubble, and the laws of bubbles is that all bubbles burst. The problem is, this bubble is causing a dramatic amount of damage to our economy and to individuals. Those of us that have studied speculations and bubbles understand that, when there was speculation and a bubble with respect to tulips, tulip bulbs didn't mean very much, because tulip bulbs aren't essential; with respect to oil, oil is essential to our economy, and what's happening today is hurting this economy and the American people.

Now, what's happened, in my judgment, and I'm really anxious to hear the testimony at this hearing—what's happened, in my judgment, is, a lot of new entrants into the futures markets. We have hedge funds that are up to their neck in futures markets, we have investment banks up to their necks in futures markets, investment banks even buying oil storage capability in order to store oil, for the first time, and keep it off the market. We've got a lot of actions being undertaken that undermine what would normally be the forces of the free market in which supply and demand would determine what the price of oil might be.

I have a chart that shows the price of oil and a chart that shows the entrance of speculators. The chart showing the price of oil, which we all know, we see—we've seen what's happened to the price of oil, and there's nothing with respect to the fundamentals that justifies where that line has moved. And, second, the amount of speculation—that is, percentage of oil owned by speculators—is a line that looks pretty much the same. This dark money with respect to this speculation has moved. It migrates from regulated exchanges to unregulated exchanges overseas. No one quite knows all of the facts here, except that people that drive to the gas pump understand the pain, the personal pain for them and their families, and this country understands the pain through truckers that are trying to figure out how to keep going, how to make a living, airlines who are determining whether they have to go bankrupt or not. All of these have significant impact on our economy.

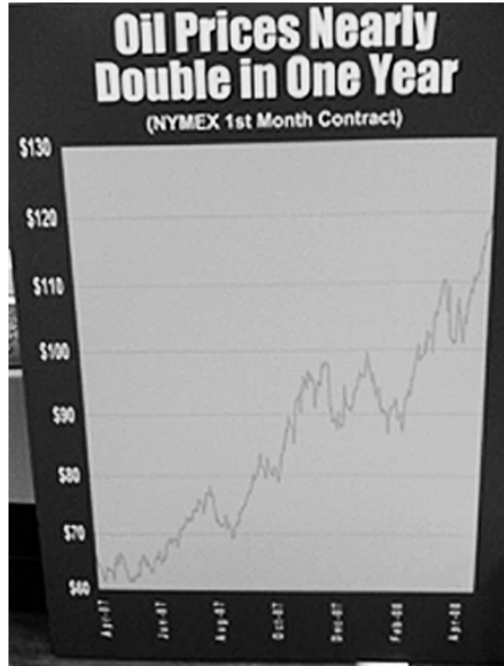

Chart 1.—Price of oil over one year.

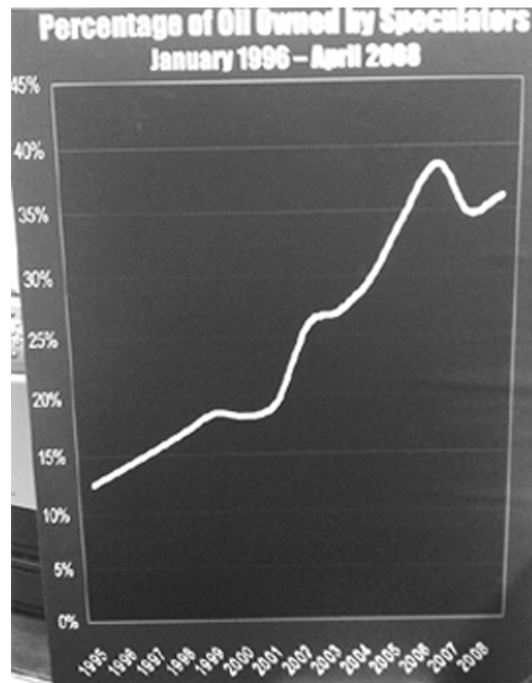

Chart 2.—Percentage of oil owned by Speculators, 1995–2008.

Senator DORGAN. And, Senator Cantwell, I would just make the point that I have long felt and have spoken at length about this, there is nothing in the fundamentals that justify what has currently happened, and we should, and must, through the CFTC, through the Federal Trade Commission and other devices, find a way to wring this speculation out of these markets and get back to something that reflects a price relating to the fundamentals of supply and demand.

I appreciate the opportunity to make a comment.

Senator CANTWELL. Thank you.

Senator Sununu——

STATEMENT OF HON. JOHN E. SUNUNU, U.S. SENATOR FROM NEW HAMPSHIRE

Senator SUNUNU. Well, thank you——

Senator CANTWELL.—opening statement?

Senator SUNUNU. Pardon me?

Senator CANTWELL. Opening statement? Thank you.

Senator SUNUNU. Thank you, Madam Chairman.

Madam Chairman, you talked about the record increase in energy prices. We've also seen record increases in other commodity and future prices in area of food, for example, and it's absolutely essential that the regulatory bodies that we have understand what's driving this run-up in prices and work to identify any cases of market manipulation, any illegal activity that might be an underlying cause, and to fully prosecute that market manipulation and illegal activity. The FTC has a role, that Senator Dorgan mentioned—the CFTC, the SEC. We want to make sure that each of these regulatory agencies has the right jurisdiction, has the right tools and the right powers of enforcement to address any case of illegal activity.

And it's important, maybe first and foremost, because this kind of market manipulation can drive—in driving price increases, can drive inflation, and that has an impact on the inflation price indices. But, let's face it, it has an impact at the pump, it has an impact at the grocery checkout counter, as well, that people have been feeling directly over the past several months.

There's also an impact, though, on our markets, the exchanges themselves, and I want to make sure that our U.S.-based exchanges are the world leaders for trading financial products, because it's important. It's important to our economy. And if we want our exchanges to be world leaders, they need to have transparency and speed and integrity. And if there's market manipulation, if there's illegal activity, our exchanges, whether they're for commodities or futures or equities or other financial instruments, they lose their integrity. That's one of the reasons I think this is an important hearing, an important topic to discuss.

I'm pleased to see that we have a very distinguished panel. I have to admit I'm especially interested to hear what Mr. Soros has to say, because, like so many Americans, I'm curious to hear what someone who's made billions of dollars on speculation has to say about speculation. So, I welcome you all. I look forward to the testimony.

And I thank you, Madam Chairman.

Senator CANTWELL. Thank you, Senator Sununu.
Senator Klobuchar?

STATEMENT OF HON. AMY KLOBUCHAR, U.S. SENATOR FROM MINNESOTA

Senator KLOBUCHAR. Thank you very much, Madam Chairman, for holding this hearing.

To our witnesses, I just spent the last week in my home state of Minnesota, where I heard many tales of woe, with regard to gas prices, of people who are deciding not to go up to their lake cabin as many weekends as they would. Normally, little mom-and-pop resorts that I can tell you are not luxurious, are having trouble because people—middle-class people simply can't afford to go up and spend a week vacation up in northern Minnesota. The high price of energy has inflated everything for people, from their food and their transportation, and is affecting our economy, as well, our business sector in Minnesota.

I've talked to people who just fill up half their tank with gas. I'm not sure what purpose that serves, except that they simply don't have the cash to be able to fill up their full tank with gas.

I believe, in the long term, we have to make significant changes in this country with a bold energy policy, and this means much more research that should have been done 10 years ago into hybrid cars, electric cars, it also means the work that needs to be done with alternative fuels as we move to the next generation of cellulosic ethanol, to look at different types of biomass that we can use, from switchgrass to prairie grass to other forms of biomass, because we simply can't continue the way we are, spending $600,000 a minute on foreign oil.

In the short term, however, I'm very intrigued by the topic today. The basis for my interest in this was, first of all, when the oil executives testified before Congress. I was struck by some of their statements on April 1. It is April Fool's Day. But, on April 1 a senior vice president for Exxon said the price of oil should be about $50 to $55 per barrel. We also have a major merger going on in Minnesota with Delta and Northwest Airlines, who are very concerned about that. That's our—corporate headquarters of Northwest is in Minnesota. But, when those two CEOs testified in two different committees, they both pointed to the price of oil. They also pointed to speculation as one of their concerns. I thought that was interesting, as well. So, you're hearing it on all levels.

As you know, the farm bill closed the Enron loophole. I'm hoping that that will be helpful. But, I think the bottom line is, as a former prosecutor—I know you can write all the laws you want, we can come up with fancy laws, but if we don't have the enforcement of these laws, we're not going to get to where we want to go.

In my old job we used to say "follow the money and you find the bad guys," and so, I want to follow the money here and figure out how American consumers are getting ripped off.

I appreciate the work of Senator Cantwell and Senator Dorgan on this. The idea that increasing the margin requirement for oil trades, I think, is a good one, and also looking at some of this offshore trading. So, I hope you're going to comment on those, because

those are two things that we're seriously looking at as ways to get at this speculation issue.

But, the bottom line, as Senator Cantwell said, is, we need a cop on the beat, we also need some prosecutors on the beat. But, I want to know, from all of you, how you think we best and quickly get at this speculation issue, because the long-term solutions are much bigger than what we're going to talk about today, but I know there's more we can do in the short term with speculation.

Thank you, and I look forward to hearing your testimony.

Senator CANTWELL. Thank you, Senator Klobuchar.

Senator Vitter?

STATEMENT OF HON. DAVID VITTER, U.S. SENATOR FROM LOUISIANA

Senator VITTER. Thank you, Madam Chair, and I look forward to the testimony, as well.

The specific title of this hearing seems to be "Market Manipulation," and certainly I agree we need to ensure that that doesn't go on, and have proper enforcement and rulemaking to ensure that. I tend to think active illegality or active manipulation is probably a small part of the picture, so I hope we also talk in a much broader sense about the role of speculation and what that has done to the market, particularly in the last year, and look at that, as well.

I think there is significant evidence that that does play a major role in at least the pace of the increases we've seen recently. I guess I disagree a little bit with Senator Dorgan, that the fundamentals don't suggest a significant increase over time. I think a lot of fundamentals do suggest that, but not, perhaps, at the pace we've seen.

So, I hope we look this—at this as an important piece of the equation, and also not forget about the fundamentals, the increased demand from growing powers, like China and India, and the need to address those fundamentals on the supply side, as well.

So, I look forward to the testimony.

Senator DORGAN. Senator Cantwell, let me just say, I didn't say "over time." I talked about the fundamentals that exist today. A big difference.

Senator CANTWELL. Thank you.

Well, let's turn to our witnesses.

Again, we thank you for being here and making time in your schedule to give testimony on this important hearing.

First, we will hear from George Soros, Chairman of Soros Fund Management. He is a world-renowned expert in financial markets and recently published a book I found helpful, *The New Paradigm for Financial Markets: The Credit Crisis of 2008 and What It Means*.

Mr. Soros, thank you for being here today, and we look forward to your testimony.

STATEMENT OF GEORGE SOROS, CHAIRMAN, SOROS FUND MANAGEMENT, LLC

Mr. SOROS. Thank you very much——

Senator CANTWELL. And, if you could, just turn your microphone on and maybe pull it closer to you so we can capture your——

Mr. SOROS. I'm very honored to be invited to testify before your Committee.

As I understand it, you are seeking an explanation for the recent sharp rise in the oil futures and in gasoline prices. In particular, you want to know whether this rise constitutes a bubble, and, if it is a bubble, whether better regulation could mitigate the harmful consequences.

In trying to answer these questions, I must stress that I'm not an expert in oil markets; I have, however, made a lifelong study of bubbles, so I will briefly outline my theory of bubbles, which is at odds with the conventional wisdom, and then discuss the current situation in the oil market.

I shall focus on financial institutions investing in commodity indexes as an asset class, because this is a relatively recent phenomenon and it has become the elephant in the room in the futures market.

According to my theory, every bubble has two components: a trend based on reality and a misconception or misinterpretation of that reality, of that trend. Financial markets are usually very good at correcting misconceptions, but occasionally misconceptions can lead to bubbles, because they can reinforce the prevailing trend; and, by doing so, they also reinforce the misconception, until the gap between reality and the market's interpretation of reality becomes unsustainable. The misconception is recognized as a misconception, disillusionment sets in, the trend is reversed. A decline in the value of collaterals provokes margin calls and distressed selling, causes an overshoot in the opposite direction. And the bust tends to be shorter and sharper than the boom that preceded it.

Now, this sequence contradicts the prevailing theory of financial markets which is based on the belief that markets are always right and deviations from equilibrium occur in a random manner. The various synthetic financial instruments, like CDOs and CLOs, which have played such an important role in turning the subprime crisis into a much larger financial crisis, have been built on that belief. But, the prevailing theory is wrong. Deviations can be self-reinforcing.

We are currently experiencing the bursting of a housing bubble and, at the same time, a rise in oil and other commodities, which has some of the earmarks of a bubble. I believe the two phenomena are connected in what I call a "super bubble" that has evolved over the last quarter of a century. The misconception in that super bubble is that markets tend toward equilibrium and deviations are random.

So much for bubbles, in general.

With respect to the oil market, I believe there are four major factors at play which mutually reinforce each other:

First, the increasing costs of discovering and developing new reserves and the accelerating depletion of existing oil fields as they age. This goes under the rather misleading name of "peak oil."

Second, there is what may be described as a backward-sloping supply curve. As the price of oil rises, oil-producing countries have less incentive to convert their oil reserves underground, which are expected to appreciate in value, into dollar reserves above ground, which are losing their value. In addition, the high price of oil has

allowed political regimes which are inefficient and hostile to the West to maintain themselves in power; notably in Iran, Venezuela, and Russia. Oil production in these countries is declining.

Third, the countries with the fastest growing demand—notably, the major oil producers, China and the other Asian exporters—keep domestic energy prices artificially low by providing subsidies; therefore, rising prices don't reduce demand, as they would under normal conditions.

Fourth, both the trend for lowering speculation and institutional commodity index buying reinforce the upward pressure on prices. Commodities have become an asset class for institutional investors, and they are increasing allocations to that asset class by following an index buying strategy. Recently, spot prices have risen far above the marginal costs of production and far-out forward contracts have risen much faster than spot prices. Price charts have taken on a parabolic shape which are characteristic of bubbles in the making.

So, is this a bubble? The answer is that the bubble is superimposed on an upward trend in oil prices that has a strong foundation in reality. The first three factors I mentioned are real and would persist even if speculation and commodity index buying were eliminated. In discussing the bubble element, I shall focus on institutional buying of commodity indexes as an asset class, because it fits so perfectly my theory about bubbles.

Index buying is based on a misconception. Commodity indexes are not a productive use of capital. When the idea was first promoted, there was a rationale for it. Commodity futures were selling at discounts from cash, and institutions could pick up additional returns from this so-called "backwardation." Financial institutions were indirectly providing capital to producers who sold their products forward in order to finance production. That was a legitimate investment opportunity. But, the field got crowded, and that profit opportunity disappeared. Nevertheless, the asset class continues to attract additional investment, just because it has turned out to be more profitable than other asset classes. It's a classic case of a misconception that is liable to be self-reinforcing in both directions.

I find commodity index buying eerily reminiscent of a similar craze for portfolio insurance which led to the stock market crash of 1987. In both cases, the institutions are piling in on one side of the market, and they have sufficient weight to unbalance it. If the trend were reversed and the institutions as a group headed for the exit as they did in 1987, there would be a crash.

To be sure, a crash in the oil market is not imminent. The danger currently is in the opposite direction. The rise in oil prices aggravates the prospects for a recession. Only when a recession is well and truly in place is a declining consumption in the developed world likely to outweigh the other factors I have listed.

That makes it desirable to discourage commodity index buying while it is still inflating the bubble. There's a strong prima facie case against institutional investors pursuing a commodity index buying strategy. It is intellectually unsound, potentially destabilizing, and distinctly harmful in its economic consequences.

When it comes to taking any regulatory measures, however, the case is less clear cut. Regulations may have unintended adverse consequences. For instance, they may push investors further into

unregulated markets which are less transparent and offer less protection. But, it may be possible to persuade the institutional investors that they are violating the prudent man's rule by acting as a herd, just as they did in 1987. If not, buying commodities, as distinct from investing in commodity-producing enterprises, should be disqualified as an asset class for ERISA institutions. The various techniques for circumventing speculative position limits should be banned, provided the ban can be made to apply to unregulated, as well as regulated, markets.

Now, raising margin requirements would have no effect on commodity index buying strategy of financial institutions, because they use cash. Nevertheless, it would be justified in current circumstances, because it would discourage speculation and speculation can distort prices. Varying margin requirements and minimum reserve requirements are tools that ought to be used more actively to prevent asset bubbles from inflating. This is one of the main lessons to be learned from the recent financial crisis.

Finally, dealing with the bubble element should not divert our attention from the interrelated problems of global warming, energy security, and so-called "peak oil." Although they are beyond the scope of these hearings, these are pressing issues that require urgent attention.

I hope my remarks are helpful to your deliberations. Thank you.

[The prepared statement of Mr. Soros follows:]

PREPARED STATEMENT OF GEORGE SOROS, CHAIRMAN, SOROS FUND MANAGEMENT, LLC

Madame Chairperson, distinguished Members, I am honored to be invited to testify before your Committee. As I understand it, you are seeking an explanation for the recent sharp rise in the oil futures market and in gasoline prices. In particular, you want to know whether this rise constitutes a bubble and, if it is a bubble, whether better regulation could mitigate the harmful consequences.

In trying to answer these questions, I must stress that I am not an expert in oil markets. I have, however, made a life-long study of bubbles. So I will briefly outline my theory of bubbles—which is at odds with the conventional wisdom—and then discuss the current situation in the oil market. I shall focus on financial institutions investing in commodity indexes as an asset class because this is a relatively recent phenomenon and it has become the "elephant in the room" in the futures market.

According to my theory, every bubble has two components: a trend based on reality and a misconception or misinterpretation of that trend. Financial markets are usually very good at correcting misconceptions. But occasionally misconceptions can lead to bubbles because they can reinforce the prevailing trend and by doing so they also reinforce the misconception until the gap between reality and the market's interpretation of reality becomes unsustainable. The misconception is recognized as a misconception, disillusionment sets in, and the trend is reversed. A decline in the value of collaterals provokes margin calls and distress selling causes an overshoot in the opposite direction. The bust tends to be shorter and sharper than the boom that preceded it.

This sequence contradicts the prevailing theory of financial markets, which is based on the belief that markets are always right and deviations from equilibrium occur in a random manner. The various synthetic financial instruments like CDOs and CLOs which have played such an important role in turning the subprime crisis into a much larger financial crisis have been built on that belief. But the prevailing theory is wrong. Deviations can be self-reinforcing. We are currently experiencing the bursting of a housing bubble and, at the same time, a rise in oil and other commodities which has some of the earmarks of a bubble. I believe the two phenomena are connected in what I call a super-bubble that has evolved over the last quarter of a century. The misconception in that super-bubble is that markets tend toward equilibrium and deviations are random.

So much for bubbles in general. With respect to the oil market in particular, I believe there are four major factors at play which mutually reinforce each other.

First, the increasing cost of discovering and developing new reserves and the accelerating depletion of existing oil fields as they age. This goes under the rather misleading name of "peak oil".

Second, there is what may be described as a backward-sloping supply curve. As the price of oil rises, oil-producing countries have less incentive to convert their oil reserves underground, which are expected to appreciate in value, into dollar reserves above ground, which are losing their value. In addition, the high price of oil has allowed political regimes, which are inefficient and hostile to the West, to maintain themselves in power, notably Iran, Venezuela and Russia. Oil production in these countries is declining.

Third, the countries with the fastest growing demand, notably the major oil producers, and China and other Asian exporters, keep domestic energy prices artificially low by providing subsidies. Therefore rising prices do not reduce demand as they would under normal conditions.

Fourth, both trend-following speculation and institutional commodity index buying reinforce the upward pressure on prices. Commodities have become an asset class for institutional investors and they are increasing allocations to that asset class by following an index buying strategy. Recently, spot prices have risen far above the marginal cost of production and far-out, forward contracts have risen much faster than spot prices. Price charts have taken on a parabolic shape which is characteristic of bubbles in the making.

So, is this a bubble? The answer is that the bubble is super-imposed on an upward trend in oil prices that has a strong foundation in reality. The first three factors I mentioned are real and would persist even if speculation and commodity index buying were eliminated. In discussing the bubble element I shall focus on institutional buying of commodity indexes as an asset class because it fits so perfectly my theory about bubbles.

Index buying is based on a misconception. Commodity indexes are not a productive use of capital. When the idea was first promoted, there was a rationale for it. Commodity futures were selling at discounts from cash and institutions could pick up additional returns from this so-called "backwardation." Financial institutions were indirectly providing capital to producers who sold their products forward in order to finance production. That was a legitimate investment opportunity. But the field got crowded and that profit opportunity disappeared. Nevertheless, the asset class continues to attract additional investment just because it has turned out to be more profitable than other asset classes. It is a classic case of a misconception that is liable to be self-reinforcing in both directions.

I find commodity index buying eerily reminiscent of a similar craze for portfolio insurance which led to the stock market crash of 1987. In both cases, the institutions are piling in on one side of the market and they have sufficient weight to unbalance it. If the trend were reversed and the institutions as a group headed for the exit as they did in 1987 there would be a crash.

To be sure a crash in the oil market is not imminent. The danger currently comes from the other direction. The rise in oil prices aggravates the prospects for a recession. Only when a recession is well and truly in place is a decline in consumption in the developed world likely to outweigh the other factors I have listed. That makes it desirable to discourage commodity index trading while it is still inflating the bubble.

There is a strong prima facie case against institutional investors pursuing a commodity index buying strategy. It is intellectually unsound, potentially destabilizing and distinctly harmful in its economic consequences.

When it comes to taking any regulatory measures, however, the case is less clear cut. Regulations may have unintended, adverse consequences. For instance, they may push investors further into unregulated markets which are less transparent and offer less protection. It may be possible to persuade institutional investors that they are violating the "prudent man's rule" by acting as a herd just as they did in 1987. If not, buying commodities—as distinct from investing in commodity producing enterprises—should be disqualified as an asset class for ERISA institutions. The various techniques for circumventive speculative position limits should be banned, provided the ban can be made to apply to unregulated as well as regulated markets.

Raising margin requirements would have no effect on the commodity index buying strategy of financial institutions because they use cash. Nevertheless, it would be justified because it would discourage speculation, and speculation can distort prices. Varying margin requirements and minimum reserve requirements are tools that ought to be used more actively to prevent asset bubbles from inflating. This is one of the main lessons to be learned from the recent financial crisis.

Finally, dealing with the bubble element should not divert our attention from the inter-related problems of global warming, energy security and so-called "peak oil". Although they are beyond the scope of these hearings, these are pressing issues that require urgent action.

I hope my remarks are helpful to your deliberations. Thank you.

Senator CANTWELL. Thank you, Mr. Soros.

Now we turn to Professor Greenberger, University of Maryland Law School, former Director of Trading and Markets at the CFTC, and who has worked with the President's Working Group on Financial Markets.

Mr. Greenberger, welcome.

STATEMENT OF MICHAEL GREENBERGER, PROFESSOR, UNIVERSITY OF MARYLAND SCHOOL OF LAW; AND FORMER DIRECTOR, DIVISION OF TRADING AND MARKETS, COMMODITY FUTURES TRADING COMMISSION (CFTC)

Mr. GREENBERGER. Thank you.

I've submitted a lengthy statement, attempting to anticipate in detail many of the issues that have arisen over this—over these concerns.

Today, let me just say this. Senator Klobuchar said, "We passed the 'End the Enron Loophole.' I hope it's enforced." The "End the Enron Loophole," because it was written by the Intercontinental Exchange, handed to the CFTC, and then handed to Congress, does not deal with crude oil. By its language, it appears to deal with crude oil, but the CFTC has announced it will not use that to bring unregulated crude oil markets under United States regulatory control.

Why is that? Senator Cantwell talked about the London-Dubai loophole. The CFTC takes the position that West Texas Intermediate contracts sold in the United States by U.S.-owned or U.S.-affiliated exchanges, because they have some tangential relationship to either London or Dubai, should be regulated, in the case of Dubai, by the Dubai Financial Services Authority. The CFTC, on May 20, 2007, reached a decision that it would not regulate Dubai's entrance into the United States markets, because Dubai has comparable futures regulation to the United States. What that suggests is, when your constituents come to you and ask you, "Is speculation under control?" if you want to leave the status quo as it is, you must tell them, "I believe so, because I have every confidence that Dubai will protect those Minnesota citizens who can't go to their summer homes." The CFTC has abdicated its responsibility to the Financial Services Authority in the United Kingdom and to the Dubai Financial Services Authority for 30 percent of the West Texas Intermediate U.S.-delivered contracts sold in the United States of America.

That is an outrage, and no one ever bothered to tell Congress, when it was working on the "End the Enron Loophole," which, by the way, in my testimony, I show, even if it did apply, it is the biggest joke in the world, because it was written by the exchange that needs to be regulated. It puts 1,000 burdens on the CFTC and the public to prove that there needs to be regulation. Prior to the—Senator Phil Gramm's introduction in the middle of the night, of the "End the"—of the "Enron Loophole," every futures contract sold in

the United States of America—every futures contract—oil, collateralized debt obligations, credit default swaps—had to be traded, pursuant to regulation that had age-old and time-tested controls on speculators. In one fell swoop, 262 pages of deregulation was added to an 11,000-page omnibus fiscal appropriation bill as Congress was leaving for its recess in December 2000, and that did not call for "better regulation," it called for "no regulation." That led to the Enron West Coast electricity crisis. There's no doubt about that. The day before the documents were released evidencing that crisis, on May 15, 2002, Chairman Newsome, of the CFTC, made a speech that electricity crisis is a supply demand crisis. Documents were released showing how the unregulated—unregulated—speculative Enron online trading engine drove prices up 300 percent in the West Coast.

Senator Cantwell has testified about the Bonneville Power Administration. In the middle of that bubble, they locked in long-term contracts, thinking the price would go up forever. When the bubble burst, they had contracts that were three—long-term contracts, commitments to pay 300 percent of the then-market price of natural gas.

The "End the Enron Loophole" is a joke. Turning this regulation over to Dubai and the English is a joke. The English regulators oversaw the collapse of the Northern Rock Bank in London. That bank first got $100 billion in loans from the British government and was then nationalized. The FSA, to whom we are delegating regulation of crude oil, has said, of its own regulation of Northern Rock, "We dropped the ball." Two weeks ago, the European Union opened an investigation over the failure of the Financial Services Authority in London to properly regulate that bank. The only individual in the world who will now say, as he has recently said in a letter to the Financial Times, that the FSA is "a model regulator," is the Acting Chair of the CFTC, Mr. Walter Lukken. Even the other Commissioners—Bart Chilton went to London and said, "The FSA is not regulating."

But, you bear the burden, unless you change things, of saying to your constituents, "Hey, I can't regulate this. We've got an exchange in Atlanta, the Intercontinental Exchange, with U.S. trading engines trading United States West Texas Intermediate oil, and, don't worry, the United Kingdom is on the case." And now Dubai has entered the market, so you will have to say, "Dubai is on the case."

We must bring these matters under our regulatory regime. We must toughen that regime. The CFTC has dragged its heels. Its May 29 release is evidence that it's dragged its heels. The FTC must be encouraged to quickly move into this area and do the proper investigation, as FERC did in the natural gas markets. If we do not do anything, we may be in a bubble, but it's an iron bubble, and it's an iron bubble because these investment banks and these hedge funds, knowing they control the price of these products through the futures markets, because they manipulate it upwards, are buying the underlying commodity.

The largest holder of heating oil in New England is Morgan Stanley. The bubble will be hard to burst as long as Mr. Soros's theory that they're not going to exchange that heating oil for U.S.

dollars because they're driving the price of heating oil up, and that forces the U.S. dollar down—it's a very bad trade. There is mini-hoarding going on in New England and all over this country by investment banks and hedge funds that are holding energy products that can be stored, will not release them, because it's a bad trade. They can drive those commodity prices up and downgrade the U.S. dollar. They don't want to take dollars for those products.

I'd be happy to answer any other questions. Thank you.

[The prepared statement of Mr. Greenberger follows:]

PREPARED STATEMENT OF MICHAEL GREENBERGER, PROFESSOR, UNIVERSITY OF MARYLAND SCHOOL OF LAW; AND FORMER DIRECTOR, DIVISION OF TRADING AND MARKETS, COMMODITY FUTURES TRADING COMMISSION (CFTC)

Introduction

My name is Michael Greenberger. I want to thank the Committee for inviting me to testify on the important issue that is the subject of today's hearings.

After 25 years in private legal practice, I served as the Director of the Division of Trading and Markets (T&M) at the Commodity Futures Trading Commission (CFTC) from September 1997 to September 1999. In that capacity, I supervised approximately 135 CFTC personnel in CFTC offices in DC, New York, Chicago, and Minneapolis, including lawyers and accountants who were engaged in overseeing the Nation's futures exchanges. During my tenure at the CFTC, I worked extensively on, *inter alia,* regulatory issues concerning exchange traded energy derivatives, the legal status of over-the-counter (OTC) energy derivatives, and the CFTC authorization of trading of foreign exchange derivative products on computer terminals in the United States.

While at the CFTC, I also served on the Steering Committee of the President's Working Group on Financial Markets (PWG). In that capacity, I drafted, or oversaw the drafting of, portions of the April 1999 PWG Report entitled "Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management," which recommended to Congress regulatory actions to be taken in the wake of the near collapse of the Long Term Capital Management (LTCM) hedge fund, including Appendix C to that report which outlined the CFTC's role in responding to that near collapse. As a member of the International Organization of Securities Commissions' (IOSCO) Hedge Fund Task Force, I also participated in the drafting of the November 1999 IOSCO Report of its Technical Committee relating to the LTCM episode: "Hedge Funds and Other Highly Leveraged Institutions."

After a two-year stint between 1999 and 2001 as the Principal Deputy Associate Attorney General in the U.S. Department of Justice, I began service as a Professor at the University of Maryland School of Law. At the law school, I have, *inter alia,* focused my attention on futures and OTC derivatives trading, including academic writing and speaking on these subjects. I have designed and teach a course entitled "Futures, Options, and Derivatives," in which the United States energy futures trading markets are featured as a case study of the way in which unregulated or poorly regulated futures and derivatives trading cause dysfunctions within those markets and within the U.S. economy as a whole, including causing the needlessly high prices which energy consumers now pay because of the high probability of excessive speculation and illegal manipulation and fraud within those markets.

The question whether there has been manipulation of U.S. energy futures markets in general, and U.S. delivered crude oil contracts specifically, has been the subject of many hearings. I have previously testified at three of those hearings, the most recent held on December 12, 2007 hearing before the Subcommittee on Oversight and Investigations of the U.S. House Committee on Energy and Commerce. To put the issue of today's hearing in context, I summarize the points I made at that hearing immediately below.

Summary of Prior Testimony

One of the fundamental purposes of futures contracts is to provide price discovery in the "cash" or "spot" markets. Those selling or buying commodities in the "spot" markets rely on futures prices to judge amounts to charge or pay for the delivery

of a commodity.[1] Since their creation in the agricultural context decades ago, it has been widely understood that, unless properly regulated, futures markets are easily subject to distorting the economic fundamentals of price discovery (*i.e.,* cause the paying of unnecessarily higher or lower prices) through excessive speculation, fraud, or manipulation.

The Commodity Exchange Act (CEA) has long been judged to prevent those abuses. Accordingly, *prior* to the hasty and last minute passage of the Commodity Futures Modernization Act of 2000 (CFMA), "all futures activity [was] confined by law (and eventually to criminal activity) to [CFTC regulated] exchanges alone."[2] At the behest of Enron, the CFMA authorized the "stunning" change to the CEA to allow the option of trading energy commodities on deregulated "exempt commercial markets," *i.e.,* exchanges exempt from CFTC, *or any other* federal or state, oversight, thereby rejecting the contrary 1999 advice of the President's Working Group on Financial Markets. *Id.* This is called "the Enron Loophole."

Two prominent and detailed bipartisan studies of the Permanent Subcommittee on Investigations (SPI) staff represent what is now conventional wisdom: hedge funds, large banks and energy companies, and wealthy individuals have used "exempt commercial energy futures markets" to drive up needlessly the price of energy commodities over what economic fundamentals dictate, adding, for example, what the SPI estimated to be at $20–$30 per barrel to the price of a barrel of crude oil at a time when that commodity had reached a then record high of $77. The conclusion that speculation has added a large premium to energy products has been corroborated by many experts, including most recently and most prominently, George Soros.[3]

The SPI staff and others have identified the Intercontinental Exchange (ICE) of Atlanta, Georgia as an unregulated facility upon which considerable exempt energy futures trading is done. For purposes of facilitating exempt natural gas futures, ICE is deemed a U.S. "exempt commercial market" under the Enron Loophole. For purposes of its facilitating U.S. WTI crude oil futures, the CFTC, by informal staff action, deems ICE to be a U.K. entity not subject to direct CFTC regulation even though ICE maintains U.S. headquarters and trading infrastructure, facilitating,

[1] *See* Written Testimony of Professor Michael Greenberger, *Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation?: Hearing Before the H. Subcomm. on Oversight and Investigations,* 3–5 (2007) available at *http://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1011&context=cong__test* (last visited June 1, 2008).

[2] PHILIP MCBRIDE JOHNSON & THOMAS LEE HAZEN, COMMODITIES REGULATION 28 (Cumm. Supp. 2008).

[3] *See, e.g.,* Edmund Conway, *George Soros: rocketing oil price is a bubble,* DAILY TELEGRAPH (May 27, 2008) available at *http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/05/26/cnsoros126.xml* (last visited June 1, 2008) (quoting Mr. George Soros as stating "Speculators are largely responsible for driving crude prices to their peaks in recent weeks and the record oil price now looks like a bubble"); Written Testimony of Michael Masters, *Hearing Before the Committee on Homeland Security and Governmental Affairs,* U.S. Senate 2 (May 20, 2008) available at *http://hsgac.senate.gov/public/__files/052008Masters.pdf* (last visited June 1, 2008) (quoting Michael W. Masters as stating "Are Institutional Investors contributing to food and energy price inflation? And my unequivocal answer is YES"); Alejandro Lazo, *Energy Stocks Haven't Caught Up With Oil Prices,* WASH. POST (Mar. 23, 2008) available at *http://www.washingtonpost.com/wpdyn/content/article/2008/03/21/AR2008032103825.html* (last visited June 1, 2008) (quoting Mr. Fadel Gheit as stating "The largest speculators are the largest financial companies"); Michelle Foss, United States Natural Gas Prices to 2015, Oxford Institute for Energy Studies 34 (2007) available at *http://www.oxfordenergy.org/pdfs/NG18.pdf* (last visited June 1, 2008) (asserting "The role of speculation in oil markets has been widely debated but could add upwards of $20 to the price per barrel"); *Economist Blames Subsidies for Oil Price Hike,* ADVANTAGE BUS. MEDIA (2008), available at *http://www.chem.info/ShowPR.aspx?PUBCODE=075&ACCT=0000100&ISSUE=0609&ORIGRELTYPE=DM&RELTYPE=PR&PRODCODE=00000&PRODLETT=M&CommonCount=0* (last visited June 1, 2008) (quoting Dr. Michelle Foss as stating "We have an overpriced commodity, and this is going to be around for a while"); Kenneth N. Gilpin, *OPEC Agrees to Increase Output in July to Ease Oil Prices,* N.Y. TIMES (June 3, 2004) available at *http://www.nytimes.com/2004/06/03/business/03CNDOIL.html?ei=5007&en=5dbd50c5b369795b&ex=1401681600&partner=USERLAND&pagewanted=all&position* (last visited June 1, 2008) (quoting Mr. Kyle Cooper as stating "There is not a crude shortage, which is why OPEC was so reluctant to raise production."); *Speculators 'not to blame' for oil prices,* UPSTREAM, (April 4, 2008) available at *http://www.upstreamonline.com/live/article151805.ece* (last visited June 1, 2008) (quoting Mr. Sean Cota as stating "It has become apparent that excessive speculation on energy trading facilities is the fuel that is driving this runaway train in crude prices"); Mike Norman, *The Danger of Speculation,* FOXNEWS.COM (Aug. 19, 2005) available at *http://www.foxnews.com/story/0,2933,166038,00.html* (last visited June 1, 2008) (Mr. Norman stating "Oil prices are high because of speculation, pure and simple. That's not an assertion, that's a fact. Yet rather than attack the speculation and rid ourselves of the problem, we flail away at the symptoms.").

inter alia, at 30 percent of trades in U.S. WTI futures. That staff informal action may be terminated instantly by the CFTC under existing law.[4]

Virtually all parties now agree the Enron Loophole must be repealed. The simplest way to repeal would be to add two words to the Act's definition of "exempt commodity" so it reads: an exempt commodity does "not include an agriculture *or energy* commodity;" and two words to 7 U.S.C. § 7(e) to make clear that "agricultural *and energy* commodities" must trade on regulated markets. An "energy commodity" definition must be then be added to include crude oil, natural gas, heating oil, gasoline, heating oil, metals, etc.[5] In the absence of quick CFTC action permitted by law, the statute should also be amended to forbid an exchange from being deemed an unregulated foreign entity if its trading affiliate *or* trading infrastructure is in the U.S.; *or* if it trades a U.S. delivered contract within the U.S. that significantly affects price discovery.

A Critique of the Farm Bill's "End the Enron Loophole" Provision

On May 22, 2008, the Food Conservation and Energy Act of 2008[6] (the "Farm Bill") was enacted into law by a Congressional override of President Bush's veto. Title XIII of the Farm Bill is the CFTC reauthorization act, which, in turn, includes a provision that was intended to "close" the Enron Loophole.[7] Rather than returning to the status quo ante prior to the passage of the Enron Loophole by simply bringing all energy futures contracts within the full U.S. regulatory format with exceptions to regulation granted on a case-by-case basis under section 4(c) of the CEA, the Farm Bill amendment requires the CFTC and the public to prove on a case-by-case basis through lengthy administrative proceedings that an *individual* energy contract should be regulated if the CFTC can prove that that contract "serve[s] a significant price discovery function in order to detect and prevent "manipulation."[8] This contract-by-contract process will take months, if not years, to complete and it will then only apply to a single contract. It will doubtless be followed by lengthy and costly judicial challenges during which the CFTC and the energy consuming public will be required to show that its difficult burden has been met. It has also been widely reported that the CFTC intends to use the new legislation to show that only a single unregulated natural gas futures contract, *and not any crude oil futures contracts,* should be removed from the Enron Loophole and be fully regulated. Thus, by CFTC pronouncement, crude oil, gasoline and heating oil futures contracts will not be covered by the new legislation.

It bears repeating that regulatory approach within the Farm Bill amendment, especially as narrowly construed by the CFTC, differs completely from the regulatory concept underlying the Commodity Exchange Act prior to the passage of the Enron Loophole. Before that highly deregulatory measure was enacted, *all* energy futures contracts were automatically covered by the Act's protections (*i.e.,* recognizing that the very nature a publishing the prices of futures contract is to provide price discovery) unless the proponent of the contract carried the burden of demonstrating to the CFTC that lesser or no regulation is required under § 4(c) of the Act, *i.e.,* that there will be no fraud or manipulation pursuant to less than the full regulatory posture. In other words, the burden had been on the traders to show on a case-by-case basis that a contract should be deregulated; the Farm Bill puts the burden, and an expensive one at that, to prove on a case-by-case basis that an energy futures contract should be regulated.

Moreover, the Farm Bill's attempt to end the Enron Loophole will doubtless lead to further regulatory arbitrage. If the CFTC should be able to prove that an individual energy futures contract has contract has a "significant price discovery function," and thus should be subject to regulation, traders will almost certainly simply move their trading to equivalent contracts that remain exempt from regulation. This was the exact strategy employed by Amaranth when NYMEX imposed speculation limits on it in the natural gas futures market. Amaranth simply moved those trades that exceeded NYMEX limits to the unregulated ICE exchange, where no speculation limits were in place.[9]

Again, the easiest course to end the Enron Loophole was not chosen as part of the Farm Bill. The most effective closure would have simply returned the Commodity Exchange Act to the status quo ante prior to passage of the Enron Loophole.

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[4] *See* Greenberger, *supra* note 1, at 11–12 (giving a complete discussion of the no action letter process including termination).

[5] *See* Greenberger, *supra* note 1, at 17 (providing a complete explanation of this solution).

[6] Food Conservation and Energy Act of 2008, Pub. L. No. 110–234, § 13201; 122 Stat. 923 (2008).

[7] *Id.*

[8] *Id.*

[9] Greenberger, *supra* note 1, at 7.

To accomplish this, would have required a two word change in two sections of the Act, requiring that "energy" commodities be treated as "agricultural" commodities, thereby requiring that all energy futures trading (as is now true of all agricultural futures trading) be done on regulated exchanges unless the regulated exchange demonstrates the need for a legitimate regulatory exemption to CFTC under § 4(c) of the Act.[10]

The Farm Bill Did Not Close the "Foreign" Board of Trade Exemption

As mentioned above, the Intercontinental Exchange (ICE) of Atlanta, Georgia for purposes of its facilitating U.S. delivered WTI crude oil futures, is deemed by the CFTC, by an informal staff action, to be a U.K. entity not subject to direct CFTC regulation even though ICE maintains U.S. headquarters and trading infrastructure, facilitating, *inter alia,* at 30 percent of trades in U.S. WTI futures. Moreover, as will be shown below,[11] the Dubai Mercantile Exchange, in affiliation with NYMEX, a U.S. exchange, has also commenced trading the U.S. delivered WTI contract on U.S. terminals, but is, by virtue of a CFTC no action letter, regulated by the Dubai Financial Service Authority. The CFTC has made it clear that the Farm Bill amendment could not be applied to cover any U.S. delivered crude oil futures contracts on the ICE or DME. Instead, those U.S. trades can only be regulated by the U.K. and Dubai, respectively.

It has been a fundamental tenet, recognized by exchanges all over the world, that if the trading of futures contracts takes place within the United States, that trading, unless otherwise exempted or excluded by the Act itself or by the CFTC through an exemption granted pursuant to the Futures Trading Practices Act of 1992, (otherwise referred to as section 4(c)), is subject to the regulatory jurisdiction of the Commodity Futures Trading Commission.[12] Recognition of that sweeping reach of U.S. jurisdiction is evidenced by the fact that most major foreign futures exchanges have asked the CFTC for an exemption from the full regulatory requirements of the Commodity Exchange Act (CEA) to which they might otherwise be subject in order to allow those foreign entities to conduct trading in the U.S. on U.S.-based trading terminals of foreign delivered futures contracts.[13] That exemption, premised on section 4(c), has been issued to many foreign exchanges through staff no action letters, which permit trading on a foreign exchanges) U.S.-based terminals without that exchange being subject to U.S. statutory or regulatory requirements.[14]

These staff no action letters have been referred to as Foreign Board of Trade exemptions (FBOTs)—a term which as of today is nowhere found in the CEA. This exemption was entirely the creation of CFTC staff and it has never been formally approved by the Commission itself.

The FBOT staff no action letters include many conditions controlling the scope of the exemption.[15] For example, the foreign exchange must be regulated in its "home" country by a regulatory entity that ensures that there will be no fraud, manipulation, or excessive speculation on those exchanges and otherwise offers a equivalent §regulatory format to that of the CFTC.[16] These staff no action letters also require that the foreign exchange submit trading data directly to the CFTC on the latter's request for enforcement or investigative purposes and that the home regulator similarly make its own trading data available to the CFTC upon request.[17] The FBOT staff no action letter contemplates, for example, if fraud, manipulation or excessive speculation affecting U.S. commodity markets were detected by the CFTC, the no action letter would be terminated immediately and enforcement proceedings would

[10] For the precise description of this two word legislative fix, *see* Greenberger, *supra* note 1, at 13–14, 17.

[11] *See infra* notes 62–66 and accompanying text.

[12] Johnson & Hazen, Derivatives Reg., section 4.05[6] at p. 984 (2004 ed.) ("[E]ven without substantial activity in the United States, jurisdiction will exist [even] when conduct abroad has a substantial effect on U.S. markets or U.S. investors." (footnotes and citations omitted).

[13] *See* U.S. Commodity Futures Trading Commission, Foreign Boards of Trade Receiving Staff No Action Letters Permitting Direct Access from the U.S., *http://services.cftc.gov/sirt/sirt.aspx?Topic=ForeignTerminalRelief* (last visited May 29, 2008).

[14] *Id.* (showing that the commission has issued eighteen no action letters to foreign boards of trade).

[15] *See* 17 C.F.R. 140.99 (2008); CFTC Regulation 140.99 (2008); *e.g.,* U.S. Commodity Futures Trading Commission, Access to Foreign Markets from the U.S., available at *http://www.cftc.gov/international/foreign marketsandproducts/foreignmkts.html* (last visited May 29, 2008).

[16] Greenberger, *supra* note 1, at 11–12; *e.g.,* LIFFE Administration & Management, CFTC No-Action Letter, 1999 CFTC Ltr. LEXIS 38, 64–66 (July 23, 1999).

[17] Greenberger, *supra* note 1, at 12; *e.g.,* LIFFE, *supra* note16, at 68–71.

be commenced by the CFTC against the foreign exchange for its adverse impacts on U.S. markets and U.S. consumers.[18]

The staff FBOT no action letter process never contemplated that an exchange owned by or affiliated with a U.S. entity would escape the CFTC regulation imposed on traditional U.S. exchanges.[19] Nor did it contemplate that foreign exchanges would trade U.S. delivered contracts in direct competition with U.S. exchanges fully regulated by the CFTC.[20] Finally, because the step of authorizing foreign exchanges to trade on U.S. soil was so fraught with unforeseen potential problems, the staff FBOT no action letters by their terms can be terminated for any reason or for no reason.[21]

In response to this staff FBOT no action process, virtually every major foreign exchange in the world has placed its terminals within the U.S. pursuant to a no action letter.[22] The latter factor evidences that fact that those many foreign exchanges recognize that they cannot obtain desirable liquidity or compete effectively worldwide without a U.S. terminal presence. It is therefore a further fundamental tenet of futures trading that foreign exchanges must have a U.S. presence to do trading. However, none of these FBOT exchanges, save the Intercontinental Exchange (ICE) and the Dubai Mercantile Exchange (DME) mentioned below, is owned by or affiliated with a U.S. entity; nor do they trade U.S. delivered futures contracts.

The former International Petroleum Exchange (IPE), a British exchange then trading foreign delivered petroleum contracts with trading matching done in London, received a CFTC staff FBOT no action letter permitting the presence of U.S. IPE terminals to trade foreign contracts.[23] In 2001(?), IPE was bought by the Intercontinental Exchange an Atlanta-based, U.S.-owned exchange whose prominent founders were, *inter alia,* Goldman Sachs, Morgan Stanley and British Petroleum.[24]

Sometime after 2001, it is my understanding that the trade matching computerized systems for all ICE trades were brought to the United States. ICE has a U.K. subsidiary, ICE Futures Europe, but that that subsidiary is does not ultimately control the trading on ICE; nor, as I understand it, are the ICE trade matching engines within the U.K.[25] In January, 2006, ICE announced that it would trade West Texas Intermediate (WTI) crude oil contracts, a contract which had theretofore been traded exclusively on the New York Mercantile Exchange (NYMEX), an exchange fully regulated by the CFTC.[26] It is my understanding that this was the first time that a "foreign" exchange operating under an FBOT traded on its U.S. terminals a U.S. delivered futures contract. Despite the fact that ICE is now a U.S.-owned exchange with U.S. trading engines trading U.S. delivered crude oil contracts, the CFTC continues to treat that exchange as a U.K. entity for purposes of its energy contracts to be directly regulated exclusively by the Financial Services Authority (FSA) of the United Kingdom.[27]

For purposes of U.S. delivered natural gas futures contracts, ICE has also been exempt from CFTC regulation by the so-called Enron Loophole passed as part of the Commodity Futures Modernization Act of 2000.[28] As part of the CFTC Reauthorization Act within the recently passed Farm Bill, provision was made for the CFTC on a case-by-case basis to demonstrate that an energy contract deregulated by the Enron Loophole has a "significant price discovery function," thereby bringing that contract under CFTC jurisdiction.[29] Were it not for the staff FBOT no action letter

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[18] Greenberger, *supra* note 1, at 12; *e.g.,* LIFFE, *supra* note 16, at 64.

[19] Greenberger, *supra* note 1, at 12.

[20] *Id.*

[21] Greenberger, *supra* note 1, at 12; *e.g.,* LIFFE, *supra* note 16, at 73.

[22] U.S. Commodity Futures Trading Commission, Foreign Boards of Trade Receiving Staff No Action Letters Permitting Direct Access from the U.S., *http://services.cftc.gov/sirt/sirt.aspx?Topic=ForeignTerminalRelief* (last visited May 29, 2008).

[23] IPE, CFTC No-Action Letter, 1999 CFTC Ltr. LEXIS 152, 53 (Nov. 12, 1999).

[24] *See* IPE, CFTC No-Action Letter, 2002 CFTC Ltr. LEXIS 90, 3 fn.3 (July 26, 2002).

[25] *See* ICE Futures Europe, available at *https://www.theice.com/about_futures.jhtml* (last visited May 29, 2008).

[26] Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, THE ROLE OF MARKET SPECULATION IN RISING OIL AND GAS PRICES: A NEED TO PUT THE COP BACK ON THE BEAT 5 (June 27, 2006).

[27] U.S. Commodity Futures Trading Commission, Foreign Boards of Trade Receiving Staff No Action Letters Permitting Direct Access from the U.S., *http://services.cftc.gov/sirt/sirt.aspx?Topic=ForeignTerminalRelief* (last visited May 29, 2008); *see, e.g.,* ICE, CFTC No-Action Letter, 2003 CFTC Ltr. LEXIS 3 (2003).

[28] *See* 7 U.S.C. § 2(h)(3) and (g) (2000).

[29] *See* Food Conservation and Energy Act of 2008, Pub. L. No. 110–234, § 13201; 122 Stat. 923 (2008). As noted above, the Farm Bill amendment has inherent weaknesses standing on its own. *See supra* notes 6–10 and accompanying text.

given to the IPE to trade foreign crude oil contracts outside of CFTC regulation, the West Texas Intermediate (WTI) futures contract traded on ICE would doubtless be deemed a contract that significantly affects price discovery under the new Farm Bill amendment. Accordingly, it would be subject to U.S. regulation.

While the plain language of the Farm Bill amendment by its terms does not contemplate exemptions for U.S. delivered contract affecting price discovery, even if traded by a foreign exchange, the CFTC and ICE have maintained that the ICE traded WTI contract will nevertheless continue to be outside the CFTC's jurisdiction even if the Farm Bill amendment were applied to it. Again, this conclusion relies, not on statutory language, but on the 1999 staff no action letter issued to the old British based IPE.[30] That is, even if the CFTC found (as it almost certainly would) that the WTI contract significantly affects the price of crude oil, gasoline, and heating oil to U.S. consumers, the CFTC and ICE have taken the position that that contract as traded on ICE will continue to be outside the CFTC's jurisdiction.[31] In short, ICE will continue to be regulated by the U.K.'s Financial Services Authority for purposes of the WTI contract traded on its U.S. terminals instead of the CFTC.

The Senate Permanent Investigating Subcommittee has now issued two reports, one in June 2006[32] and one in June 2007[33], that make a very strong (if not irrefutable case) that trading on ICE has been used to manipulate or excessively speculate in U.S. delivered crude oil and natural gas contracts.[34] The June 2006 report cited economists who then concluded that when a barrel of crude was at $77 in June 2006, $20 to $30 dollars of that cost was due to excessive speculation and/or manipulation on unregulated exchanges.[35] If that assessment is correct, at one quarter of the price of crude oil, and crude oil, derivatives, such as gasoline and heating oil, are the direct result of market malpractices by traders. Of course, we also know through U.S. enforcement actions and criminal prosecutions that Enron, using the Enron Loophole, for its Enron Online (an exchange that was deregulated in the way ICE is deregulated today), drove the price of electricity up almost 300 percent a year for California consumers in the 2000–2001 era.[36]

The CFTC has vigorously maintained that the U.K.'s FSA regulatory model is at the "forefront internationally"[37] and that it has shared meaningful market information about ICE WTI trades with the CFTC.[38] It is self evident, however, when a barrel of crude is approaching $140 and predicted by Goldman Sachs to soon pass

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[30] *See* Written Testimony of Jeffrey Harris, *Chief Economist Before the Committee on Energy and Natural Resources U.S. Senate,* 5–7 (2008) available at *http://www.cftc.gov/stellent/groups/public/ @newsroom/documents/speechandtestimony/opaharris040308.pdf* (last visited May 29, 2008); Written Testimony of Jeffrey C. Sprecher, Chairman and CEO of Intercontinental Exchange, Natural Gas Hearings (2007) available at *https://www.theice.com/showpr.jhtml?id=6685;* Written Testimony of Sir Bob Reid, Chairman ICE Futures, *Before the Commodity Futures Trading Commission Public Hearing on Foreign Boards of Trade* (2006) available at *https://www.theice.com/publicdocs/press/TESTIMONY__OF__SIR__BOB__REID__JUN__27.pdf* (last visited May 29, 2008).

[31] *See supra* note 30 and accompanying text.

[32] Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, THE ROLE OF MARKET SPECULATION IN RISING OIL AND GAS PRICES: A NEED TO PUT THE COP BACK ON THE BEAT (June 27, 2006) [hereinafter June 2006 Report].

[33] Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, EXCESSIVE SPECULATION IN THE NATURAL GAS MARKET, (June 25, 2007) [hereinafter June 2007 Report].

[34] *See* June 2007 Report at 4, 6, 8, 51–53, 111, 119; June 2006 Report at 40–41, 49.

[35] June 2006 Report, *supra* note 32, at 2, 23. George Soros recently warned that "Speculation . . . is increasingly affecting the price. . . . The price has this parabolic shape which is characteristic of bubbles." Edmund Conway, *George Soros: rocketing oil price is a bubble,* DAILY TELEGRAPH (May 27, 2008) available at *http://www.telegraph.co.uk/money/main.jhtml? xml=/money/2008/05/26/cnsoros126.xml* (last visited May 29, 2008).

[36] Peter Navarro & Michael Shames, *Aftershocks—And Essential Lessons—From the California Electricity Debacle,* 16 ELECTRICITY J. 24, 24 (2003).

[37] Walter Lukken, Acting Chairman CFTC, Letters to the Editor: CFTC proud of its strong partnership with the Fsa, FIN. TIMES (April 25, 2008) available at: *http://search.ft.com/ftArticle?queryText=%22US+regulator+takes+FSA+to+task+over+poor+derivatives+oversight&y=12&aje=true&x=9&id=080422000166&ct=0* (last visited May 29, 2008).

[38] *Id. See also* Walter Lukken, CFTC Commissioner, Remarks to the Federation of European Securities Commissions: Smart Regulation for the Global Marketplace (June 26, 2007) available at *http://www.cftc.gov/newsroom/speechestestimony/opalukken–25.html;* Walter Lukken, CFTC Commissioner, Address at the ISDA Energy, Commodities and Developing Products Conference: The Derivatives World is Flat (June 14, 2006) available at *http://www.cftc.gov/newsroom/speechestestimony/opalukken–20.html* (last visited May 29, 2008). *But see infra* notes 71–74 and accompanying textual discussion (where on May 29, 2008, the CFTC had suddenly reversed its stance in its regard).

$200[39] (with attendant high prices being paid by U.S. consumers for gasoline and heating oil) that U.S. regulators would need and want real time, fully audited data pertaining to the critically important WTI contract; rather than data passed by ICE from the U.S. to the FSA and then from the FSA to the CFTC in a haphazard, incomplete, and unaudited fashion. In fact, confidence in the legitimacy of the information being shared between the CFTC and FSA has led to the CFTC to insist on May 29 that it receive better data from the FSA and ICE in order to probe whether there has been improper "market manipulation" in the crude oil markets.[40]

Recognizing that the CFTC and ICE are taking the position that the new "End the Enron Loophole" rider on the Farm Bill will not reach WTI trading on ICE, S. 2995 was introduced on May 8, 2008, to address the FBOT exemption under which ICE is operating outside of CFTC jurisdiction for the purposes of crude oil.[41]

The major tenet of that legislation is that any exchange operating under an FBOT exemption may only do so if the CFTC finds that the non-U.S. regulator has regulation that is equivalent to that of the U.S. in several respects.[42] Acting Chairman Lukken has already repeatedly stated that he has concluded that the U.K.'s FSA regulation is not only comparable, but a model for U.S. regulators.[43] This statement is reflected in the no action letters that have already been awarded to ICE and, more recently, to the Dubai Mercantile Exchange, where the CFTC has concluded that the Dubai Financial Service Authority's regulation of oil futures markets "is the equivalent of the" CFTC.[44]

Thus, if S. 2995 is enacted, it will preserve the status quo of FBOTs being allowed to trade U.S. delivered energy future contracts within the United States, but not be subject to U.S. regulation. For example, ICE-even though U.S.-owned with U.S. trading engines, trading critically important U.S. delivered energy futures contracts (contracts that would almost certainly otherwise by regulated under the End the Enron Loophole amendment)—would continue to be regulated by the United Kingdom. Similarly, the DME, in partnership with U.S.-owned NYMEX will continue to trade the U.S. delivered WTI contract within the U.S., but be regulated by the Dubai Mercantile Exchange.

Allowing ICE, DME and other FBOTs to be regulated by foreign regulators, like the U.K.'s Financial Services Authority and the Dubai Financial Service Authority, undermines the stability of the U.S. crude oil futures markets. CFTC Commissioner Bart Chilton has recently stated, "I am generally concerned about a lack of transparency and the need for greater oversight and enforcement of the derivatives industry by the FSA."[45] Similar concerns have been already been voiced by experts who argue that the U.K. Financial Services Authority's public disclosure, regulatory

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[39] Neil King Jr. and Spencer Swartz, *U.S. News: Some See Oil at $150 This Year—Range of Factors May Sustain Surge;* $4.50-a-Gallon Gas, WALL ST. J., May 7, 2008, at A3.

[40] U.S. Commodity Futures Trading Commission, CFTC Announces Multiple Energy Market Initiatives, available at *http://www.cftc.gov/newsroom/general pressreleases/2008/pr5503–08.html* (last visited May 30, 2008) (stating that the CFTC has begun increased surveillance of crude oil market prices); James Quinn, *Oil prices to be probed by U.S. regulator CFTC,* DAILY TELEGRAPH (May 30, 2008) available at *http://www.telegraph.co.uk/money/main. jhtml?xml=/money/2008/05/30/cnoil130.xml* (last visited May 30, 2008) (stating that the CFTC "has launched an unprecedented investigation into possible market manipulation in the U.S. crude oil market amid record prices" that has caused critical damage to the global economy).

[41] Oil Trading Transparency Act, S. 2995, 110th Cong. (2008); *e.g.,* Press Release, Levin and Feinstein Introduce Oil Trading Transparency Act (May 8, 2008) available at *http://feinstein.senate.gov/public/index.cfm? FuseAction=NewsRoom.PressReleases&ContentRecord__id=de99b838–011a–438e–02af–23a90bb2fca9&Region__id=&Issue__id=* (last visited May 29, 2008); Press Release, Levin and Feinstein Introduce Oil Trading Transparency Act (May 8, 2008) available at *http://levin.senate.gov/newsroom/release.cfm?id=297513* (last visited May 29, 2008).

[42] Oil Trading Transparency Act, S. 2995, 110th Cong. § 2(e)(1)(a) (2008).

[43] *See supra* notes 37–38 and accompanying text.

[44] *See* IPE, CFTC No-Action Letter, 1999 CFTC Ltr. Lexis 152, 53 (Nov. 12, 1999); Dubai Mercantile Exchange, CFTC No-Action Letter, 2007 CFTC Ltr. Lexis 6 (May 24, 2007).

[45] Jeremy Grant, *Companies & Markets: U.S. regulator takes FSA to task for poor derivatives oversight,* Fin. Times (April 22, 2008) available at: *http://search.ft.com/ftArticle?queryText=%22US+regulator+takes+FSA+to+task+over+poor+derivatives+oversight&y=12&aje=true&x=9&id=080422000166&ct=0* (last visited May 29, 2008); *see, e.g.,* Testimony of Jane Carlin, Chairwoman, Over-the-Counter Derivative Products Committee, Securities Industry Association, *Hearing on Commodity Futures Trading Commission Reauthorization before the House Agriculture Committee* (May 20, 1999) available at *http://www.sifma.org/legislative/testimony/archives/Carlin5–20–99.html* (last visited May 30, 2008); June 2006 Report, *supra* note 32, at 49. "To continue the present situation, in which the CFTC does not police two of three major markets trading U.S. energy futures, is to turn a blind eye to an increasingly large segment of these markets, thereby impairing the ability to detect, prevent, and prosecute market manipulation and fraud." *Id.*

oversight and enforcement actions are much more lax than the CFTC's regulation of exchanges and transactions.[46]

For example, during last summer's subprime mortgage crisis, Northern Rock PLC, one of the U.K.'s largest banks, had difficulty raising funds and borrowed billions of dollars from the U.K.'s central bank.[47] After news of the bailout was released to the public, thousands of customers wary of losing their savings stood in long lines for several days outside of Northern Rock's branches to withdraw deposits.[48] With Northern Rock on the brink of collapse, FSA provided over $100 billion in loans to the bank and in February 2008, the British government finally was required to nationalize it.[49] In March 2008, FSA published an internal report stating that its regulation of Northern Rock "was not carried out to a standard that is acceptable," and highlighted FSA's failure to provide adequate supervision, oversight, and resources.[50] In addition to FSA's self-criticism, earlier this month the European Union opened a formal investigation into FSA's restructuring of Northern Rock.[51]

This series of events exemplifies FSA's inability to provide regulatory oversight and enforcement that is equivalent to the CFTC.[52] Yet, that is the very conclusion the CFTC adopts today as it continues to look to the FSA as a "model" regulator. To the extent that S. 2995 leaves it in the hands of the FSA and the Dubai Financial Service Authority to govern the trading of WTI contracts on U.S. terminals without U.S. supervision on a finding of "comparability" or "equivalency," it affords the U.S. consumer virtually no meaningful protection from fraud, manipulation, or excessive speculation in these markets. For almost eight decades the prevention of fraud, manipulation, and excessive speculation was the foremost Congressional promise to those who need to trade in these markets to protect their commercial well being.

Indeed, the language of S. 2995 either expressly or implicitly concedes two critical points. First, there is no statute to date that provides any exemption for U.S. trading on Foreign Boards of Trade. The Commodity Exchange Act says nothing about Foreign Boards of Trade.[53] The proposed legislation then wholly endorses the concept of an FBOT exemption despite the fact that many have argued that any foreign exchange which wants to introduce trading of its contracts in the U.S. ought to be regulated by the CFTC just as U.S. Designated Contract Markets (DCMs) are so regulated.[54]

Certainly the question whether a foreign exchange may trade U.S. delivered commodities within the U.S. free of U.S. regulation should be the subject of extensive debate. S. 2995, which has not had the benefit of a full hearing in either House of Congress, by its terms when read in light of long standing CFTC practices not only sanctions U.K. regulation of ICE's WTI trading; it opens the door to any foreign exchange operating under an FBOT exemption escaping U.S. regulation for any U.S. delivered commodity, *e.g.,* the Henry Hub natural gas contract, based solely on the "comparability" finding by the CFTC—a finding which the CFTC has been quite generous in granting. Under that rationale, there is nothing to prevent the Dubai futures exchanges from trading Henry Hub natural gas futures contracts within the U.S. free of U.S. oversight on a finding by the CFTC of comparability of Dubai regulators, which the CFTC has already done in the Dubai Mercantile Exchange no ac-

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[46] *See* Allistair MacDonald, *Assessing U.K. Watchdog: FSA's Regulatory Model Gets Some Raves in U.S.; A Lapdog at Home?,* WALL STREET J., July 23, 2007, available at *http://online.wsj.com/article/SB118515214144274556.html* (last visited May 29, 2008); Steve Pearlstein, *Auditing Reform: Mission Accomplished!,* Wash. Post, Dec. 15, 2006, available at *http://www.washingtonpost.com/wp-dyn/ content/article/2006/12/14/AR2006121401796.html* (last visited May 29, 2008).

[47] *See* BBC NEWS, *Rock expects* £30bn loan this year, Nov. 7, 2007, available at *http://news.bbc.co.uk/1/hi/business/7073556.stm* (last visited May 29, 2008).

[48] *See Crisis deepens for Northern Rock,* REUTERS Sep. 17, 2007, available at *http://www.iht.com/articles/2007/09/17/asia/17northern.php* (last visited May 29, 2008).

[49] *See* Stephen Castle, *EU to investigate Northern Rock nationalization in Britain,* INTERNATIONAL HERALD TRIBUNE, April 2, 2008, available at *http://www.iht.com/articles/2008/04/02/business/rock.php* (last visited May 29, 2008).

[50] *See* ASSOCIATED PRESS, *British regulator admits failings in oversight of Northern Rock, announces new procedures,* INTERNATIONAL HERALD TRIBUNE, March 26, 2008, available at *http://www1.wsvn.com/news/articles/world/MI81198/* (last visited May 29, 2008).

[51] *See* Castle, *supra* note 49.

[52] It is also worth noting that "the FSA places an emphasis on deterrence, rather than the use of high-profile prosecutions and fines in the US." Grant, *supra* note 45.

[53] *See generally* Oil Trading Transparency Act, S. 2995, 110th Cong. § 2 (2008); Commodity Exchange Act, 7 U.S.C. § 1 (2008).

[54] *See, e.g.,* Ian Talley, *Congress Seeks to Curb Oil Speculation,* SMARTMONEY (May 28 , 2008) available at *http://www.smartmoney.com/breaking-news/ON/index.cfm?story=ON–20080528–000641–1015* (last visited May 29, 2008).

tion letter. If that were to happen, the only salient feature of the End the Enron Loophole amendment (regulating Henry Hub natural gas contracts which are now traded on ICE outside of an FBOT exemption) would be undercut by foreign exchanges escaping that reform by trading in the U.S. under their foreign flag and being regulated by their "comparable" foreign regulator.

I understand that the argument has been advanced by certain investment banks and their representatives that if Congress does not accede to S. 2995, they have threatened to move their trading "offshore" to escape U.S. regulation of foreign exchanges.[55] However, the entire history of these markets is that every foreign exchange badly needs to trade within the U.S. That is evidenced by the eighteen staff FBOT no action letters issued to foreign exchanges to date.[56] The desire to be in the U.S. is so prevalent that ICE apparently brought its IPE trading engines and trading matching systems to the U.S.-not just its trading terminals.[57]

The argument is also advanced that the investment banks will figure out a clever technological way to "trade abroad" with U.S.-based technology that will fall short of traditional terminals. In that way, these traders say they can stay within the U.S. but appear to be trading offshore. However, if there is any trading in the U.S. of any kind (whatever the technology) of a futures contract within the U.S. of a futures contract anywhere, it is subject to U.S. jurisdiction.[58] Indeed, if U.S. citizens manipulate foreign exchanges, they are subject to criminal sanctions and, in most instances, would be extradited back to the U.S. to face criminal charges if not civil fines if that impacted domestic markets and those exchanges had any meaningful contacts with the U.S.[59]

Indeed, if one were to be swept away by speculative and hypothetical fever proffered by the investment banks about the terrible things that would happen if S. 2995 does not pass, why would one not worry that a U.S. exchange, such as NYMEX, might flee U.S. restrictions by affiliating with a "foreign" exchange freed from U.S. supervision under the proposed legislation. NYMEX has already established joint ventures with Dubai, which the CFTC finds to be a country with comparable regulation.

Foremost is the Dubai Mercantile Exchange, which is a joint venture between NYMEX, Tatweer (a member of Dubai Holding) and the Oman Investment Fund.[60] This entity is regulated by the Dubai Financial Services Authority[61] and was granted a CFTC no action letter in 2007.[62] As of May 16, 2008, the DME with NYMEX as its partner received CFTC approval to begin trading WTI contracts.[63] In this way, NYMEX now effectively participates in the trading of the DME of a critically important U.S. delivered contract on U.S. terminals owned by the DME while escaping U.S. oversight on the DME's U.S. terminals. I worry that NYMEX's escape from U.S. control of these U.S. DME trades is wholly consistent with S. 2995.[64]

Finally, S. 2995 does not incorporate all of the conditions within the present FBOT no action letter typically issued by CFTC staff.[65] Most importantly, the legis-

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[55] *See* Carlin, *supra* note 45.

[56] U.S. Commodity Futures Trading Commission, Foreign Boards of Trade Receiving Staff No Action Letters Permitting Direct Access from the U.S., *http://services.cftc.gov/sirt/sirt.aspx?Topic=ForeignTerminalRelief* (last visited May 29, 2008).

[57] *See* IPE, CFTC No-Action Letter, 1999 CFTC Ltr. Lexis 152 (Nov. 12, 1999). The letter explained the "request, on behalf of The International Petroleum Exchange of London Limited, ("IPE" or "Exchange") and its members, that the Division grant no-action relief to permit IPE to make its electronic trading and order matching system, known as Energy Trading System II (ETS), available to IPE members in the United States." *Id.*

[58] *See* Johnson & Hazen, *supra* note 12.

[59] *See* Press Release, Department of Justice, U.S. Charges 47 After Long-Term Undercover Investigation Involving Foreign Exchange Markets, and (Nov. 19, 2003), available at *http://www.fbi.gov/dojpressrel/pressrel03/wooden111903.htm.*

[60] Dubai Mercantile Exchange (DME), *http://www.dubaimerc.com/* (last visited May 29, 2008).

[61] *Id.*

[62] Dubai Mercantile Exchange, CFTC No-Action § Letter, 2007 CFTC Ltr. Lexis 6 (May 24, 2007).

[63] Babu Das Augustine, *Dubai 'could emerge as derivatives trading hub',* GULFNEWS.COM (May 16, 2008) available at *http://www.gulfnews.com/business/General/10213595.html* (last visited June 1, 2008).

[64] *See generally* Oil Trading Transparency Act, S. 2995, 110th Cong. § 2 (e)(1)(a) (2008).

[65] *See id.;* 17 C.F.R. 140.99 (2008); CFTC Regulation 140.99 (2008). Some officials are also skeptical of the assertion that the CFTC and FSA have comparable regulatory structures because, "exchanges in London are not required to monitor daily trading to prevent manipulation, publish daily trading information, or impose and enforce position limits that prevent excessive speculation." Senator Dianne Feinstein & Senator Olympia J. Snowe, Letter to Walter Lukken, Acting Chair of the Commodity Futures Trading Commission (2008) available at *http://fein-*

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lation does not provide (as to the staff FBOT no action letters) that upon detecting fraud, manipulation, or excessive speculation by the FBOT, the CFTC can terminate the no action letter and/or can charge traders on FBOT for those malpractices. S. 2995 leaves that issue untouched and, by implication, I fear that it will allow the CFTC to follow its well worn path of least resistance: *i.e.,* place enforcement responsibilities on the Dubai Financial Services Authority, for example, to remedy excessive gasoline prices paid by American consumers. In sum, voters, I am sure, will not accept lightly a pronouncement of Congressional futility evidenced by a failure to insist on full U.S. regulation of U.S. trading in U.S. delivered commodities by U.S.-owned entities merely because certain U.S. resident managers of, *inter alia,* U.S. investment banks and hedge funds have threatened to take their business (but not themselves) to foreign countries—especially when those threats defy every basic premise of futures trading, *i.e.,* the need of each of each the world's futures exchanges wherever they are located to have a vibrant U.S.-based market. Once futures trading of any kind is initiated within, or has substantial impacts upon, the U.S., the trader is fully subject to U.S. civil and criminal jurisdiction. If those traders wish to leave the U.S. permanently to conduct their business and otherwise enjoy their leisure time abroad, it seems self evident that that is a circumstance that the overwhelming majority of your constituents now unnecessarily paying $4.00 and up for a gallon of gasoline will gladly accept.

The CFTC's Newly Announced "Multiple Energy Market Initiatives"

For at least the last 2 years, two Acting Chairmen of the CFTC (Sharon Brown-Hruska and then Walter Lukken), and the CFTC Chief Economist, Jeffrey Harris, have repeatedly assured Congress, market participants, and anyone else who would listen, that the dramatic rise in crude oil, natural gas, gasoline, heating oil, and agricultural products is caused exclusively by supply/demand market fundamentals.[66] These regulators have based their conclusions on the CFTC's "exhaustive" research of all relevant market data.[67]

Indeed, as recently as May 20, 2008 before the full Senate Homeland Security and Government Affairs Committee, the CFTC's Mr. Harris, testified that "'all the data we have analyzed indicates that that little economic evidence exists that demonstrates that futures prices are being systematically driven by the speculators in the [agriculture] and energy markets.' . . . [O]ur comprehensive analysis of the actual position data of these traders fails to support the contention" that there is excessive speculation or manipulation. Rather, he said prices are being driven "by powerful economic fundamental forces and the laws of supply demand." [68]

I have already cited the abundance of informed academic and trader opinion that reaches conclusions quite the opposite of those of Ms. Brown-Hruska and Messrs.

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stein.senate.gov/public/index.cfm?FuseAction=NewsRoom.PressReleases&ContentRecord__id=c9784c93–0be4–0e7d-e6b2–05bce9339894&IsPrint=true (last visited May 29, 2008).

[66] Walt Lukken, CFTC, Acting Chairman, Prepared Remarks: Compliance and Enforcement in Energy Mkts.—The CFTC Perspective (Jan. 18, 2008) available at *http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opalukken–34.pdf* (last visited June 1, 2008) (quoting Mr. Walter Lukken "While speculators play a integral role in the futures markets, the report concludes that speculative buying, as a whole does not appear to drive up price."); Tina Seeley, *Energy Mkts. Not Manipulated, U.S. Regulator Says* (Update 1), BLOOMBERG.COM (May 7, 2008), available at *http://www.bloomberg.com/apps/news?pid=20601072&sid=aX0iaEd9bOMU&refer=energy* (last visited June 1, 2008) (quoting Mr. Walter Lukken "We have not seen that speculators are a major factor in driving these prices."); Ian Talley and Stephen Power, *Regulator Faults Energy-Futures Proposal,* Wall St. J. (May 9, 2008), (stating that Mr. Walter Lukken commented that his agency hadn't seen evidence indicating that speculators are "a major factor" in driving up oil prices); Oral Testimony of Walter L. Lukken, Commissioner, CFTC, *Before the Committee on Agriculture, U.S. House of Representatives,* (April 27, 2006) (quoting Mr. Walter Lukken "[B]ased on our surveillance efforts to date, we believe that crude oil and gasoline futures markets have been accurately reflecting the underlying fundamentals of these markets."); Sharon Brown-Hruska, CFTC, Chairman, *Address before the International Monetary Fund: Futures Mkts. in the Energy Sector* (Jun. 15, 2006) available at *http://www.cftc.gov/newsroom/speechestestimony/opabrownhruska–46.html* (last visited Jun. 1, 2008) (stating "To date, the staff's findings have shown that these large speculators as a group tend to inject liquidity into the markets rather than having an undue impact on price movements.") (last visited June 1, 2008); Sharon Brown-Hruska, CFTC, Chairman, *Keynote Address at the Managed Funds Association Annual Forum* (Jun. 25, 2005) available at *http://www.cftc.gov/opa/speeches05/opabrownhruska34.htm* (last visited June 1, 2008) (stating the CFTC's study of the role of managed funds in our markets, "[C]ontradicts with force the anecdotal observations and conventional wisdom regarding hedge funds and speculators, in general.").

[67] *See, e.g., supra* note 66 and accompanying text.

[68] Richard Hill, *Lieberman Says He Will Consider Legislation to Address Commodity Prices,* 40 BNA 21 (May 26, 2008)) (emphasis added).

Lukken and Harris.[69] Those who have blamed speculation as a material factor in the rise of energy prices have estimated, for example, that up to $90 of the present price of the barrel of crude oil has nothing to do with supply/demand, but, instead, is caused by unpoliced trader malpractices.[70]

In a rather dramatic about face, the CFTC suddenly announced on May 29, 2008 (or just 9 days after Mr. Harris' testimony) that that agency will now collect substantial amounts of new data to determine what is undergirding high energy prices.[71] That release was divided into three parts: (1) an attempt to collect additional data not previously within the CFTC's possession about trading activities pertaining to ICE's WTI contracts; (2) the collection of new data pertaining to "index trading" by swaps dealers, *e.g.,* certain investment banks and hedge funds; and (3) the public announcement of an ongoing nationwide crude oil investigation commenced by the CFTC in December 2007 looking into possible unlawful trading malpractices.

Suffice to say for now that the credibility of well over 2 years of assurances by Ms. Brown-Hruska and Messrs. Lukken and Harris that all was fine in these markets based on the CFTC's analysis of "comprehensive" data has been wholly undermined by the May 29 release. It is now clear that the data that was being analyzed by the CFTC as the basis of its assurances of regularity in these markets was, as many had repeatedly warned over the last 2 years, totally inadequate and unreliable. There can be little doubt that this complete reversal by the CFTC was not motivated by a newly minted aggressive regulatory stance. Rather, it was almost driven by political forces that no longer allowed Messrs. Lukken and Harris to continue their rosy assessment.

First, it is certainly more than a mere coincidence that the now revealed CFTC investigation into manipulation of the oil markets is said to have begun in December 2007. As shown below,[72] that was the very month that this Congress mandated that the FTC-rather than the CFTC—examine the crude oil futures markets, especially in light of the CFTC's foot dragging. Nothing has spurred the CFTC into action over these last 4 years more than legislation undercutting its regulatory turf.

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[69] *See, e.g.,* Edmund Conway, *George Soros: rocketing oil price is a bubble,* DAILY TELEGRAPH (May 27, 2008) available at *http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/05/26/cnsoros126.xml* (last visited June 1, 2008) (quoting Mr. George Soros as stating "Speculators are largely responsible for driving crude prices to their peaks in recent weeks and the record oil price now looks like a bubble"); Written Testimony of Michael Masters, *Hearing Before the Committee on Homeland Security and Governmental Affairs,* U.S. Senate, 2 (May 20, 2008) available at *http://hsgac.senate.gov/public/__files/052008Masters.pdf* (last visited June 1, 2008) (quoting Mr. Michael W. Masters as stating "Are Institutional Investors contributing to food and energy price inflation? And my unequivocal answer is YES"); Alejandro Lazo, *Energy Stocks Haven't Caught Up With Oil Prices,* WASH. POST ONLINE (Mar. 23, 2008) available at *http://www.washingtonpost.com/wpdyn/content/ article/2008/03/21/AR2008032103825.html* (last visited June 1, 2008) (quoting Mr. Fadel Gheit as stating "The largest speculators are the largest financial companies"); Michelle Foss, *United States Natural Gas Prices to 2015,* Oxford Institute for Energy Studies 34 (2007) available at *http://www.oxfordenergy.org/pdfs/NG18.pdf* (last visited June 1, 2008) (asserting "The role of speculation in oil markets has been widely debated but could add upwards of $20 to the price per barrel"); *Economist Blames Subsidies for Oil Price Hike,* ADVANTAGE BUS. MEDIA, (2008), available at *http://www.chem.info/ShowPR.aspx?PUBCODE=075&ACCT=0000100&ISSUE=0609&ORIGRELTYPE=DM&RELTYPE=PR&PRODCODE= 00000&PRODLETT=M&CommonCount=0* (last visited June 1, 2008) (quoting Dr. Michelle Foss as stating "We have an overpriced commodity, and this is going to be around for a while"); Kenneth N. Gilpin, *OPEC Agrees to Increase Output in July to Ease Oil Prices,* N.Y. TIMES (June 3, 2004) available at *http://www.nytimes.com/2004/06/03/business/03CNDOIL.html?ei=5007&en=5dbd50c5b369795b&ex=1401681600&partner=USERLAND&pagewanted=all&position* (last visited June 1, 2008) (quoting Mr. Kyle Cooper as stating "There is not a crude shortage, which is why OPEC was so reluctant to raise production."); *Speculators 'not to blame' for oil prices,* UPSTREAM, (April 4, 2008) available at *http://www.upstreamonline.com/live/article151805.ece* (last visited June 1, 2008) (quoting Mr. Sean Cota as stating "It has become apparent that excessive speculation on energy trading facilities is the fuel that is driving this runaway train in crude prices"); Mike Norman, *The Danger of Speculation* FOXNEWS.COM, (Aug. 19, 2005) available at *http://www.foxnews.com/story/0,2933,166038,00.html* (last visited June 1, 2008) (Mr. Norman stating "Oil prices are high because of speculation, pure and simple. That's not an assertion, that's a fact. Yet rather than attack the speculation and rid ourselves of the problem, we flail away at the symptoms.").

[70] *See* Alexander Kwiatkowski and Grant Smith, *Blame Wall Street for $135 Oil on Wrong-Way Betting* (Update 3), BLOOMBERG.COM (May 22, 2008) available at *http://www.bloomberg.com/apps/news?pid=20601087&refer=home&sid=a3MgWEz__Qch0* (last visited June 1, 2008).

[71] Press Release, U.S. Commodity Futures Trading Commission, CFTC Announces Multiple Energy Market Initiatives, available at *http://www.cftc.gov/newsroom/general pressreleases/2008/pr5503–08.html* (last visited May 30, 2008).

[72] Energy Independence and Security Act of 2007, Pub. L. No. 110–140 § 811, 121 Stat. 1492 (2007).

We need only look at the comparable scenario created by Congress in 2005 when it gave FERC the authority to explore natural gas futures markets in light of the record high natural gas prices at that time.[73] That legislation also caused the CFTC to abandon its long standing assertion that the rise in natural gas prices was caused by supply/demand only in order to protect its primacy in overseeing the natural gas futures markets. As noted above,[74] to date, neither the courts nor Congress has been kind to the CFTC in its attempt to undercut FERC's efforts to police natural gas futures markets. The same will doubtless be true when the CFTC attempts to elbow the FTC out of its crude oil investigations.

Second, the month of May 2008 has otherwise been unkind to the CFTC because of mounting harsh criticism for the agency's noblesse oblige attitude toward the economic distress of the American consumer faced with crippling gas prices. Those criticisms have been joined by further threats to cut back on CFTC authority. For example, Senator Lieberman, Chairman of the Senate Homeland Security and Government Affairs Committee, at that Committee's May 20 hearing flatly rejected Mr. Harris' assurances there that speculation is not at play in energy and agricultural price dysfunctions. Senator Lieberman called for the study of dramatic legislative measures that would bypass the CFTC and directly bar by legislative directive speculators from both energy and agricultural futures markets.[75]

Senator Lieberman's and other legislative conclusions about the adverse impact of speculation were doubtless driven by the testimony of Michael W. Masters, Managing Member of Masters Capital Management, LLC, at the May 20 hearing.[76] Mr. Masters showed that investment banks and hedge funds, for example, who were "hedging" their off exchange bets on energy prices on regulated exchanges were quite remarkably and inexplicably being treated by NYMEX, for example, and the CFTC as "commercial interests," rather than as the speculators they self evidently are.[77] By lumping these investment banks and hedge funds with traditional commercial oil dealers, even U.S. fully regulated exchanges were not applying traditional speculation limits to the transactions engaged in by these speculative interests.[78] Mr. Masters demonstrated beyond all doubt that a huge percentage of the trades in WTI futures, for example, were controlled by non-commercial interests.[79] It is now clear that the CFTC in its pre-May 29 assurances had never before examined the positions of these "swaps dealers," because in that release it required these banks and hedge funds to report their trades to the CFTC and the CFTC committed "to review whether classification of these types of traders can be improved for regulatory and reporting purposes."[80]

Indeed, Senator Bingaman, Chairman of the Senate Energy Committee and Natural Resources Committee in a May 27, 2008 letter to Acting Chairman Lukken, stated: "[I] remain concerned that the Commission's assertions to date—discounting the potential role of speculation in driving up oil prices—have been based on a *glaringly incomplete set of data*."[81] Senator Bingaman referenced not only the likelihood of the CFTC not having adequate data on foreign boards of trade who do business in the U.S. or the over-the-counter unregulated futures markets, but the CFTC's sanctioned practice of "classify[ing] so-called 'swaps dealers'—including large investment banks [—] as 'commercial' market participants, alongside physical hedgers such as oil companies and airlines, rather than as 'non-commercial participants,'" the latter of whom would be subject to speculation limits.[82] In other words, Senator Bingaman realized that when Messrs. Lukken and Harris had been assuring the Senate Energy and Natural Resources Committee that speculators played no role

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[73] Energy Policy Act of 2005, Pub. L. No. 109–58, 119 Stat. 594 (2005).
[74] *See infra* notes 116–25 and accompanying text.
[75] *See* Hill, *supra* note 68.
[76] Written Testimony of Michael Masters, *Hearing Before the Committee on Homeland Security and Governmental Affairs,* U.S. Senate, (May 20, 2008) available at *http://hsgac.senate.gov/public/_files/052008Masters.pdf* (last visited June 1, 2008).
[77] *Id.* at 7–8.
[78] *Id.* at 7.
[79] *Id.* at 8, 11.
[80] Press Release, U.S. Commodity Futures Trading Commission, CFTC Announces Multiple Energy Market Initiatives, available at *http://www.cftc.gov/newsroom/general pressreleases/2008/pr5503–08.html* (last visited May 30, 2008).
[81] Letter from Senator Jeff Bingaman to Walter Lukken, Acting Chairman, CFTC (May 27, 2008) (emphasis added) available at *http://energy.senate.gov/public/index.cfm?FuseAction=PressReleases.Detail&PressRelease_id=0fdd0eb4-4b1d-49f0-a3a2-f89fd0e4b1d3&Month=5&Year=2008&Party=0* (last visited June 1, 2008).
[82] *Id.*

is the oil prices run up, they were not counting certain investment banks and hedge funds, for example, as speculators! [83]

Finally, a bipartisan coalition of 22 Senators on May 23, 2008 sent a strongly worded letter to the CFTC asking that agency to show cause as to why the charade of treating the U.S.-owned ICE as a U.K. entity when that exchange is run out of Atlanta, Georgia and is trading the WTI U.S. delivered crude oil contract not be ended immediately as the underlying CFTC staff FBOT no action letters allow by their express terms.[84] That Senate letter made clear that an unsatisfactory answer from the CFTC would very likely lead to further legislative diminishment of that agency's authority. Each of the above referenced factors almost certainly explain the dramatic change represented by the CFTC's May 29 release. The question remains whether the release is merely for appearances sake; or whether it truly represents seriousness on the part of the agency to finally investigate these matters.

There is evidence within the May 29 release that may call into question the sincerity of CFTC's new stance. First, the November 1999 staff FBOT no action letter that the CFTC views as governing ICE's U.S. delivered energy trades expressly gives the CFTC the absolute right to collect immediately and directly any data it needs from either the FSA (the purported U.K. regulator of the Atlanta-based ICE) or from ICE itself.[85] Ignoring the express language of the no action letters, the CFTC has now for the second time felt obliged to negotiate with FSA and ICE the right to obtain the very data it could collect under the no action letter.[86] This unneeded subservience, especially to ICE, reflects an unwillingness by the CFTC to even use effectively the power expressly granted to it by its own no action letters.

Indeed, while the CFTC publicly announced its new initiative at 1 PM on May 29,[87] at 1:05 PM that afternoon ICE felt obliged to issue a press release announcing that it had "facilitated" the turning over of the data called for in the CFTC release.[88] It is self evident that ICE, in its capacity as the second largest trader of WTI and as an unregulated U.S. exchange, was almost certainly going to be an entity of interest to the CFTC in its market investigation. The seeming subservience of the CFTC to ICE in negotiating with the exchange over the information the agency deems necessary for its investigation is akin to asking a key witness to an investigation whether and to what extent it will agree to turn over material relevant to the investigation. That is simply not the way in which serious investigation is conducted, especially when dealing with suspicions that manipulative activity may be found in these markets.

Moreover, CFTC Commissioner Bart Chilton has acknowledged that the public announcement within the May 29 release raises that specter "some people to head for the paper shredder [.]" [89]

It is also important to note that the CFTC release makes clear that it has not, in fact, finalized its agreement to obtain all of the relevant data it needs from the FSA and ICE. In this regard, there are only "near-term commitment[s]" to obtain from the FSA and ICE "more detailed identification of market end users" and "to provide improved data formatting so trading information can be seamlessly inte-

[83] *See* Gene Epstein, Commodities: Who's Behind the Boom?, Barrons (March 31 2008) available at *http://online.barrons.com/article/ SB120674485506173053.html?mod=b__hps__9__0001__b__this__weeks__magazine__home__top&page=sp* (last visited June 1, 2008) (demonstrating that a similar problem of miscategorizing investment banks and hedge funds as "commercial" farming interests exists in the agricultural futures markets).

[84] Letter from Twenty-Two Senators to Walter Lukken, Acting Chairman, CFTC (May 23, 2008), available at *http://cantwell.senate.gov/news/record.cfm?id=298325* (last visited June 1, 2008).

[85] *See supra* notes 15–18 and accompanying text.

[86] Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information Related to Market Oversight, CFTC & FSA (2006) available at *http://www.fsa.gov.uk/pubs/mou/cftc.pd;* Financial Services Authority, FSA signs regulatory cooperation agreement with the CFTC, (Nov. 20, 2006) available at *http://www.fsa.gov.uk/pages/Library/ Communication/PR/2006/118.shtml* (last visited June 1, 2008).

[87] Press Release, U.S. Commodity Futures Trading Commission, CFTC Announces Multiple Energy Market Initiatives, (May 29, 2008), available at *http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5503–08.html* (last visited May 30, 2008).

[88] Press Release, Intercontinental Exchange, Ltd., ICE Facilitates Agreement to Provide Industry's Most Comprehensive Reporting for U.S. Energy Futures Contracts, (May, 29, 2008), available at *http://ir.theice.com/releasedetail.cfm?ReleaseID=312956* (last visited June 1, 2008).

[89] Tina Seeley, *CFTC Targets Shipping, Storage in Oil Investigation* (Update2), Bloomberg.com (May 30, 2008) available at *http://www.bloomberg.com/apps/news?pid=20601087&sid=aGzRMmD__b9MA&refer=home* (last visited June 1, 2008).

grated into the CFTC's surveillance system[.]"[90] In other words, not only did the CFTC never know who the end users were trading WTI crude oil contracts on ICE (crucial information for determining which entities might be engaging in manipulative behavior) and not only did it not have any of the FSA data accessible for purposes of CFTC surveillance programs, it does not have this information today; it only has a "near term commitment" that the information will be provided. In this regard, the CFTC's assurance to Senator Lieberman only 2 weeks ago that there was no manipulation in these markets based a "comprehensive analysis of actual position data of these traders" seems to be nothing more than a flight of fancy since critical portions of that data are not even now within the possession of the CFTC after its much ballyhooed May 29 MOU with the FSA and ICE.

My own view is that there can be no "final" commitment by FSA and ICE on these "near term commitment" points, because the United Kingdom's FSA is going to have to reconfigure (or more likely reinvent) the collection of its own data in order to be able to satisfy the CFTC's investigative needs in this regard. These "near term" failures in data collection only serve to highlight the total laxity of the FSA regulatory process as it applies to these markets; the extent to which CFTC analysis has been and will be uninformed ; and the absurdity of the CFTC's continuous charade that a U.S.-owned exchange (ICE) located in Atlanta and trading critically important U.S. delivered energy products (WTI) should be regulated by the United Kingdom, whose regulation of these markets is self evidently lacking by the latter's need to mask its inadequacies through "near term commitments."

Yet, another factor within the CFTC's May 29 release evidences the weakness of relying on foreign regulators to police U.S. commodity trading. Among the new information required by the May 29 CFTC release is the requirement that ICE notify the CFTC when those who trade on ICE "exceed position accountability levels, as established by U.S. designated contract markets, for WTI crude oil contracts."[91] In other words, because FSA does not have "accountability levels" and because ICE therefore does not establish them, the CFTC is requiring ICE to comply with accountability levels at its main competitor, NYMEX.

Needless to say, that is a highly circular way in which to bring an Atlanta-based exchange trading the U.S. delivered WTI contract, but regulated by the United Kingdom, under traditional and long established U.S. controls on excessive speculation and manipulation. Again, would it not be easier to simply require this Atlanta exchange to register in the United States? The "Rube Goldberg" quality of the CFTC's reliance on the FSA would be humorous were it not be for the fact that U.S. consumers are sinking under the weight of increasing gas prices that many respectable observers believe are caused in some substantial measure by outsized speculation and possible manipulation on ICE.

Another important weakness of the CFTC release is that, while it tries to accommodate concerns about the inadequacy of the United Kingdom's regulation of ICE, the release does not address the fast growing problem of other foreign exchanges trading in the U.S. who are quickly moving into the U.S. delivered WTI contract. For example, as mentioned above,[92] the Dubai Mercantile Exchange (DME) received a May 2007 staff FBOT no action letter enabling that Dubai exchange to bring its terminals into the U.S. without registering as a CFTC regulated designated contract market. DME is joined in this endeavor by NYMEX, but its U.S. trading activities are regulated by the Dubai government.

James Newsome, the President of MYMEX, the former Chairman of the CFTC (2001–2004), and a member of the DME board of directors recently opined that "he sees big opportunities for the DME and a huge potential for [DME] emerging as the derivatives trading hub of South Asia, Middle East and Africa region."[93] He notes at the recent first anniversary of the DME WTI contract, the DME volumes "are very similar to the volumes of the WTI . . . when [it was] launched" on NYMEX itself.[94]

The Dubai/NYMEX venture is the playing out of NYMEX's long threatened strategy to level the playing field with ICE, *i.e.,* if an Atlanta-owned exchange can be regulated as if it were in the UK, a New York exchange will follow suit under the banner of an FBOT no action letter granted to a Dubai exchange. Of course, the

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[90] Press Release, U.S. Commodity Futures Trading Commission, CFTC Announces Multiple Energy Market Initiatives, available at *http://www.cftc.gov/newsroom/general pressreleases/2008/pr5503–08.html* (last visited May 30, 2008).

[91] *Id.*

[92] *See supra* note 46.

[93] Babu Das Augustine, Dubai 'could emerge as a derivatives trading Hub', Gulfnews.com, May 16, 2008, available at *http://www.gulfnews.com/business/General/10213595.html (last visited June 1, 2008).*

[94] *Id.*

CFTC May 29 release is careful to limit improved data collection only to ICE and does not address the parade of foreign exchanges to which the CFTC has offered a safe harbor from U.S. regulation.

It is self evidently absurd that the American public can rest secure that the CFTC found in the DME no action letter, that Dubai's regulatory scheme is comparable to that of the U.S.[95] The fact that the CFTC as recently as May 2007 could conclude that Dubai's regulation is in fact comparable to that in the U.S. simply demonstrates that there is not a foreign regulator in the world who would not satisfy the CFTC under that agency's comparability standard. In this regard, I am sure that the American consumers will take little comfort from an explanation that they are being protected from manipulation and excessive speculation driving up gas prices—not by U.S. regulators—but by the Dubai government's oversight of trading of the U.S. delivered WTI contract on the DME's U.S. trading terminals. I do not envy any Member of Congress explaining that proposition to his or her constituents.

Finally, NYMEX President Newsome has further opined that "[t]he reports on the role of speculators on oil prices are grossly exaggerated. If you look at the data on who is actually trading, the level of commercial participants remains 70 to 72 percent." Of course, as Michael Masters recently explained,[96] Dr. Newsome's calculation treats investment banks and hedge funds laying off the risk of their off exchange swaps transactions on NYMEX as the same as a heating oil dealer using the WTI contract on NYMEX to hedge his business risk. If those banks and hedge funds were properly classified as speculators, about 70 percent of the trading on NYMEX would be speculative—not commercial. And, if you were to add all of the WTI trading on NYMEX, ICE, and the Dubai exchange, speculation might very well approach 80–90 per cent of the WTI trades executed by U.S.-owned exchanges. By any objective assessment, the crude oil market is now overwhelmingly dominated by speculation, most of which is not subject to the age old controls imposed upon speculators in these markets. One can easily see then how Goldman Sachs, a huge trader in these markets itself, could confidently predict that oil will soon reach $200 a barrel.[97]

The Need to Expedite the FTC Investigation into Crude Oil Futures Markets

Soaring energy prices have infiltrated all sectors of the economy and they have drastically reduced the quality of life for millions of Americans. In a May 23,2008 letter to the CFTC, a bipartisan group of 22 Senators stated the depth of economic emergency caused by the oil shock: "The doubling of crude oil prices in 1 year is unprecedented in the century old history [of these markets]. With oil central to our Nation's economy and current standard of living, today's skyrocketing oil represents a massive new tax on American families and business . . ."[98] As Senator Bingaman, Chair of the Senate Energy and Natural Resources Committee, also reminded Acting CFTC Chairman Lukken last week, "American families, farmers and businesses are currently struggling under the weight of record-setting fuel prices."[99]

Faced with years of inertia by the CFTC in policing the crude oil futures markets (or for that matter even recognizing any problem worthy of an investigation), Congress included within the Energy Independence and Security Act of 2007 (EISA),[100] a provision expanding the power of the Federal Trade Commission (FTC) to combat price manipulation with respect to crude oil markets.[101] The statute specifically provided that it was:

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[95] Dubai Mercantile Exchange, CFTC No-Action Letter, 2007 CFTC Ltr. Lexis 6 (May 24, 2007).

[96] *See* Masters, *supra* notes 76–79 and accompanying text.

[97] Neil King Jr. and Spencer Swartz, *U.S. News: Some See Oil at $150 This Year—Range of Factors May Sustain Surge; $4.50-a-Gallon Gas,* WALL ST. J., May 7, 2008, at A3.

[98] Letter from Twenty-Two Senators to Walter Lukken, Acting Chairman, CFTC (May 23, 2008), available at *http://cantwell.senate.gov/news/record.cfm?id=298325* (last visited June 1, 2008).

[99] Letter from Senator Jeff Bingaman to Walter Lukken, Acting Chairman, CFTC (May 27, 2008). Letter from Twenty-Two Senators to Walter Lukken, Acting Chairman, CFTC (May 23, 2008), available at *http://cantwell.senate.gov/news/record.cfm?id=298325* (last visited June 1, 2008).) (stating that Exxon Mobile executive has testified that the price of crude oil should be between $50 to $55 dollars per barrel based on supply and demand principles).

[100] Energy Independence and Security Act of 2007, Pub. L. No. 110–140, 121 Stat. 1492 (2007).

[101] *Id.* at § 811. Although the FTC has always had the power to provide consumer protection by preventing "unfair methods of competition" and "deceptive acts" that affected commerce, until the passage of the 2007 Act, it did not have the authority to target price manipulation directly. 15 U.S.C. § 45 (2008).

> unlawful for any person, directly or indirectly, to use or employ, in connection with the purchase or sale of crude oil gasoline or petroleum distillates at wholesale, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Federal Trade Commission may prescribe as necessary or appropriate in the public interest or for the protection of United States citizens.[102]

The 2007 FTC anti-manipulation legislation is virtually identical to 2005 legislation enacted by Congress requiring FERC to investigate and prohibit market manipulation in the natural gas markets.[103] By January 2006, FERC issued a final rule under the 2005 legislation implementing its anti-manipulation provisions.[104] Pursuant to that rulemaking, FERC resolved all major interpretive issues it viewed as arising under the 2005 legislation, including adopting the anti-manipulation definitions within Section 10(b) of the Securities and Exchange Act of 1934 [and making it clear that its authority extended to investigating and crafting relief in the natural gas futures markets if manipulation of natural gas prices was found there (?)].[105] In short, FERC has provided the FTC with the template for an investigative order under the virtually identical legislation governing the FTC's mandate.

In July 2007, FERC issued a show cause order under its anti-manipulation rule against the Amaranth Advisors hedge fund, alleging that Amaranth manipulated NYMEX natural gas futures contracts to impact the price of those contracts.[106] In so doing, FERC made it clear that the term within the legislation making it "unlawful for any person, directly or indirectly, to use or employ, in connection with the purchase" of natural gas included the authority to investigate and issue appropriate relief within the natural gas futures markets, because those markets are "in connection with" the purchase of the commodity in question. FERC has now completed over 64 investigations into these markets, reaching settlements in a substantial portion of those cases.

In sum, FERC has used its 2005 legislative authority after which the 2007 FTC crude anti-manipulation legislation was modeled to resolve all major issues about the scope of its mandate, including a definition for market manipulation and a clear understanding that, if that manipulation emanates within futures markets, FERC has the statutory authority to investigate and regulate therein. Therefore, the FTC has a readymade model order, resolving many critical issues about the scope of its authority under the 2007 legislation, which should have enabled it to move quickly to determine whether the unbearably high prices experienced in the crude oil markets by U.S. consumers are related exclusively to market fundamentals or, in crucial part, to trading malpractices.

The National Emergency in the Petroleum Markets Authorizes to FTC to Move Faster

Instead of taking swift and decisive action to address the growing threat of fast rising crude oil, gasoline and heating oil prices, the FTC opted to employ a leisurely administrative route that, unless adjusted as suggested below, will mean that a rule governing investigation under the 2007 crude oil anti-manipulation legislation will not be in place until this coming fall at the earliest. Rather than issuing a proposed rule based on the model established by FERC in the natural gas markets, the FTC instituted an advanced notice of proposed rulemaking (ANOPR) with the comment period to close on June 6, 2008.[107] The ANOPR is 39 pages long and it raises in a most highly academic fashion many of the issues long ago confronted and resolved in 2005–2006 by FERC in the natural gas context.

Moreover, picking up the signal that time is not of the essence, the American Petroleum Institute (API), represented by the Covington & Burling law firm, has already requested an extension of the June 6 ANOPR deadline, claiming that the issues are too difficult to resolve in anything less than a 90 period.[108] If this extension were granted, the comment period for the ANOPR would not even end until late summer. At that juncture and pace, the FTC would then analyze the ANOPR comments before it even issued a proposed rule with its own [30] day comment period. Under this schedule (if not extended by further requests for more time),

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[102] Energy Independence and Security Act of 2007, Pub. L. No. 110–140 § 811, 121 Stat. 1492 (2007).

[103] Energy Policy Act of 2005, Pub. L.No. 109–58, 119 Stat. 594 (2005).

[104] 71 Fed. Reg. 4244 para. 6 (Jan. 26, 2006).

[105] *Id.* at para. 2.

[106] 120 F.E.R.C. P. 61085, 2007 F.E.R.C. Lexis 163 (2007).

[107] 16 C.F.R. Part 317 (2008).

[108] Letter from the American Petroleum Institute to Donald Clark, Secretary, U.S. Federal Trade Commission (May 19, 2008) available at *http://www.ftc.gov/os/comments/market manipulation/080519ampetrolinstreqeot.pdf* (last visited May 31, 2008).

months would pass before the promulgation of the final rule at which time the FTC would only then begin its investigation.

To be sure, in the absence of a full blown emergency, agency rulemaking requires a notice and comment period on a proposed rule, with the discretion to precede the proposed rule with an ANOPR to flesh out novel issues in aid of developing the proposed rule. However, the Administrative Procedure Act provides critically important exceptions to these procedures in well defined exigent circumstances. For example, the APA specifically provides that the notice and comment requirements can be bypassed or short circuited when, "the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefore in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest."[109] Therefore, when an agency faces emergencies or situations where delaying for notice and comment would seriously harm the public interest, the agency can promulgate a final rule without notice and comment, especially when the critical issues have already been resolved under an identical companion statute by another Federal agency charged with the identical investigative mission in highly related markets and by comments received by the FTC pursuant to the FTC's existing ANOPR.[110]

The present crude oil and gas price shocks presents precisely the circumstances for which the APA exception was intended. Sky rocketing oil, gasoline, and heating oil prices have placed a stranglehold on the American economy and every American consumer. George Soros recently warned that, if left unattended, the oil price crisis (which he views as being grounded in excessive speculation) will drag the United States into the most serious full blown recession since the end of World War II.[111] Surely the present crisis would allow the FTC to short circuit full blown APA procedures. Indeed, after receiving comments on the ANOPR, the FTC could model an interim final rule based on those comments and the tailor made companion FERC template. The FTC's investigation could at least proceed under the interim rule while it takes notice and comment on that interlocutory order. If the FTC acts expeditiously, it may stave off economic chaos by bringing discipline to what many sophisticated economists and market observers believe are unnecessarily chaotic markets driven by a high level of speculative manipulation.

Indeed, when FERC went through its rulemaking process on suspected manipulation leading to fast rising natural gas prices, it expedited its proceeding.[112] In that case, FERC "balanced the necessity for immediate implementation of this Final Rule against the principles of fundamental fairness" and determined that the persistent high energy prices could lead to opportunities for price manipulation.[113] FERC concluded that it "would be contrary to the public interest to delay regulations that implement Congressional intent to prohibit manipulation in energy markets[;]" implementing a Final Rule would protect energy markets from manipulation.[114] Again, because the FTC legislation is nearly identical to that enactment authorizing FERC, it is certain that Congress expected the FTC to follow the example set by FERC. Given the self-evident nature of the emergency before us, the harm that delay could cause the public, and the example of effective response given by FERC, the FTC should greatly expedite its rulemaking process in order to bring stability to the gas and oil markets.[115]

The FTC's Investigation of the Crude Oil Markets Cannot Be Blocked by the CFTC

In its ANOPR, FERC has posed the question of the degree to which the 2007 statutory mandate permits it to overlap the jurisdiction of the CFTC into the crude oil futures markets. Doubtless, the CFTC's sudden reversal of position in announcing

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[109] 5 U.S.C. § 553(b)(B) (2008).

[110] *See id.; Edison Electric Institute, et al.,* v. *EPA,* 821 F.2d 714, 720 (D.C. Cir. 1987) ("[T]here was a need for immediate action."); *Chamber of Commerce* v. *SEC,* 443 F.3d 890, 908 (D.C. Cir. 2006) (exception to notice and comment permitted "in emergency situations" or where "delay would result in serious public harm") (dicta) (citing cases).

[111] Edmund Conway, *George Soros: rocketing oil price is a bubble,* Daily Telegraph (May 27, 2008) available at *http://www.telegraph.co.uk/money/main.jhtml?xml =/money/2008/05/26/cnsoros126.xml* (last visited May 29, 2008).

[112] Prohibition of Energy Market Manipulation, 114 F.E.R.C. P61,047, 61 (F.E.R.C. 2006).

[113] *Id.*

[114] *Id.*

[115] If absolutely necessary the FTC could propose an interim rule for investigation after the ANOPR period has closed and then expedite the rulemaking process through the APA's § 553(d), until reaching a final rule.

its own investigation into these markets on May 29, 2008 was intended to aggravate that concern on the part of the FTC.[116]

An effort was made to thwart FERC in its investigation of the natural gas futures markets pursuant to the 2005 legislation by claiming it was infringing on the province of the CFTC. In *CFTC* v. *Amaranth Advisors,*[117] Amaranth tried to enjoin FERC from proceeding with its administrative action because it could face the possibility of having to defend itself in two different proceedings pertaining to the natural gas futures markets.[118] The court refused to enjoin the FERC investigation, by explaining, *inter alia,* that Congress expressly envisioned that there would be overlap between the enforcement actions of these two agencies.[119]

Important Members of Congress have also weighed in when the CFTC has attempted to preempt FERC's examination of the natural gas futures markets. For example, in a recent hearing before the Subcommittee on Oversight and Investigations of the House Committee on Energy and Commerce, the Ranking Member Joe Barton (R–TX) (who was the Committee Chair when the 2005 statute was passed) stated, "I'm also disappointed to see that CFTC has challenged FERC's authority to investigate and pursue the energy market manipulators despite the Congress's explicit grant of authority to FERC in the Energy Policy Act of 2005."[120] Acting Chairman Lukken replied that the CFTC had opposed FERC action because the Commodity Exchange Act had conferred exclusive jurisdiction over these contracts to the CFTC.[121] Rep. Barton retorted,

> Well, then there's no way you can have exclusive jurisdiction with this [2005] statutory authority on the books. And what I want to inform you of, as the acting chairman, is that this wasn't something serendipitous or inadvert[ent]. It was put in directly because of what since has transpired. And the—Mr. Kelliher [FERC Chairman] and his compadres at the FERC are doing exactly, or at least attempting to do exactly what we hoped they would do, which is work with your agency but use their own authorities to ferret out the bad actors and try to make our markets more open and transparent and accessible in a nonbiased way to any willing participant.[122]

Rep. Barton elaborated further:

> So I'm—I don't see how the—your agency or the courts can rule, unless they assume that the Members of Congress who passed this didn't know what we were talking about and didn't understand the English language. But I just, you know, I want to put on the record at this oversight hearing that this was—this particular section was done at my express request because of concerns I had at the time about speculation in the oil and gas markets so that we could give the FERC some authority, which was ambiguous at that time.[123]

Rep. Barton's statements leave little room for doubt that both FERC (under the 2005 legislation) and the FTC (under the 2007 legislation modeled after the 2005 statute) have the authority to examine the role futures markets play in manipulating the natural gas markets (in the case of FERC) and the petroleum markets (in the case of the FTC).

Finally, the mere fact that the CFTC has begun its own "investigation" into the current price calamity is no reason for the FTC to delay its own inquiry.[124] As Rep. Barton said, "This is not an area that we have too many regulators and too many overseers."[125] The enormity of the economic chaos that looms in spiking crude oil prices imperils both the stability of the global economy, as well as the American people. Given the magnitude of these issues, both agencies should cooperate to work simultaneously in this area.

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[116] *See supra* notes 71–74 and accompanying text.
[117] 523 F.Supp.2d 328 (S.D.N.Y. 2007).
[118] *Id.* at 328–29.
[119] *Id.* at 332.
[120] Rep. Joe Barton, Subcommittee on Oversight and Investigations, Statements during the Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation? (Dec. 12, 2007) (emphasis added).
[121] Walter Lukken, Acting Chairman CFTC, *Statements during the Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation?* (Dec. 12, 2007).
[122] Barton, *supra* note 120.
[123] *Id.*
[124] *See supra* notes 117–119 and accompanying text.
[125] Barton, *supra* note 120.

The FTC Is Required to Adopt SEC's Definition of Manipulation

In its ANOPR, the FTC includes a considerable discussion pertaining to the standard it should adopt in determining whether conduct is manipulative. Once again, this issue has been settled under the 2005 legislation as explained in FERC's final investigative order. Congress passed the FERC legislation in 2005 in direct response to the scandal in the natural gas markets that decimated the Western electricity markets in 2000 and 2001. The 2005 provision was modeled on the securities laws, and FERC's final order under that statute notes that the anti-manipulation provisions in the Energy Policy Act of 2005 "closely track" section 10b of the Securities Exchange Act of 1934.[126] Moreover, both statutes "specifically dictate that the terms 'manipulative or deceptive device or contrivance' are to be used 'as those terms are used in section 10(b) of the Securities Exchange Act of 1934.'"[127] FERC therefore patterned its own rule after the SEC's 10b–5 and said it would interpret its own rules "consistent with analogous SEC precedent that is appropriate under the circumstances."[128]

Similarly, Congress modeled the FTC's new 2007 anti-manipulation provision on 10(b) of the Securities Exchange Act of the 1934 and Rule 10b–5 to once again make it clear (as was the case with FERC) that the FTC must use the extensive securities precedent to guide its manipulation investigations in the petroleum markets. For example, "manipulative or deceptive device or contrivance" has clearly been defined by the SEC and adopted by FERC, and have also been interpreted by the courts. The courts have established that this standard covers "knowing or intentional misconduct" and not price changes caused by negligence or natural market forces. Rather, the SEC definition is designed to prevent fraudulent or manipulative conduct that affect market prices "that are intended to mislead . . . by artificially affecting market activity."[129] The Supreme Court has interpreted the phrases "manipulative or deceptive" in conjunction with "device or contrivance," to be applicable to intentional conduct.[130] The SEC has broadly interpreted the securities laws to attack "the full range of ingenious devices that might be used to manipulate securities prices."[131]

Accordingly, the FTC (as is true of FERC and the SEC) is not required to demonstrate reliance, loss causation, or damages, because "the Commission's duty to enforce the remedial and preventative terms of the statute in the public interest, and not merely to police those whose plain violations have already caused demonstrable loss or injury."[132]

The FTC Is Free to Investigate the Futures Trading Subsidiaries of Banks

The FTC is specifically has general authority "to prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce."[133] However, while the FTC has broad authority to protect commerce, as it has noted in the ANOPR, it explicitly prohibited from regulating, *inter alia,* "banks."[134]

As has been noted above, investment banks are prime players in the crude oil future markets. I anticipate that a question will be raised about whether the FTC can investigate those institutions.

The FTC's authorizing legislation does not provide a definition of a "bank;"[135] rather, it cross references another section of the statute, which is concerned with FTC enforcement.[136] This section provides a list of those institutions that qualify

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[126] Prohibition of Energy Market Manipulation, 114 F.E.R.C. P61,047; 2006 FERC LEXIS 105 (Jan 19, 2006).

[127] *Id.*

[128] *Id.*

[129] *Santa Fe Industries* v. *Green,* 430 U.S. 462, 476 (1977); *Mobil Corp.* v. *Marathon Oil Co.,* 669 F.2d 366, 374 (6th Cir. 1981) (holding that SEC is empowered to prevent manipulation of markets "by artificial means . . . unrelated to the natural forces of supply and demand.").

[130] Ernst & Ernst, 425 U.S. at 197, 199.

[131] Santa Fe Industries, 430 U.S. at 476.

[132] *See, e.g., SEC* v. *Credit Bancorp, Ltd.,* 195 F.Supp2d 475, 490–91 (S.D.N.Y. 2002) *quoting Berko* v. *SEC,* 316 F.2d 137, 143 (2d Cir. 1963) *citing SEC* v. *North American Research & Dev. Corp.,* 424 F.2d 63, 84 (2d Cir. 1970)(reliance not an element of a Rule 10–b(5) claim in the context of an SEC proceeding).

[133] 15 U.S.C. § 45(a)(2) (2008).

[134] *Id.*

[135] 15 U.S.C. § 44 (2008).

[136] *See* 15 U.S.C. § 57(a)(f)(2) (2008).

as "banks," and makes it clear that the term relates to depository institutions registered as in that capacity with Federal banking regulators.[137]

However, even if non-depository institutions, such as Morgan Stanley or Goldman Sachs, are for some reason deemed to be "banks" for purposes of FTC regulation, the futures trading done by those institutions are executed through subsidiaries neither registered with the banking regulators nor with the SEC.[138]

Finally, to the extent that the finds that a "bank" is involved in manipulative activity within the crude oil markets, courts have ruled that the FTC has investigatory power with regard to banks, even if enforcement activities with regard to those institutions are beyond the Commission's authority. In *FTC* v. *Rockefeller,*[139] the FTC brought suit to enforce subpoenas it had issued to various banks in order to conduct an energy-related investigation.[140] The banks sought to quash the subpoenas, arguing that the information sought ran afoul of the "bank" exemption within the FTC's governing statute.[141] The court first determined that the FTC's authority to "conduct an investigation of the energy industry is undisputed."[142] The court ultimately held that the FTC was lawfully permitted to demand information from the banks there in pursuit of its statutory obligation to investigate the energy industry.[143] For all of these reasons, the FTC should be urged by this Committee to fulfill aggressively the 2007 Congressional mandate stop any manipulative practices within the petroleum markets, including activity within the crude oil futures markets distorting crude oil prices. The path for such an investigation has already been well marked by FERC. The FTC should use all of the powers available to it to promulgate its rule and begin it investigation expeditiously. The stability of the American economy demands nothing less.

Senator CANTWELL. Thank you.

Next, we will hear from Gerry Ramm, President of Inland Oil Company, and on—speaking on behalf of the Petroleum Marketers Association.

I would like to extend a special welcome to Mr. Ramm, since he comes from Ephrata, Washington. Thank you very much for being here.

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[137] *See id.* The statute specifically mentions the following institutions as being considered banks:

(A) national banks and Federal branches and Federal agencies of foreign banks, by the division of consumer affairs established by the Office of the Comptroller of the Currency; (B) member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25(a) [25A] of the Federal Reserve Act [12 USCS §§ 601 et seq. or §§ 611 et seq.], by the division of consumer affairs established by the Board of Governors of the Federal Reserve System; and (C) banks insured by the Federal Deposit Insurance Corporation (other banks referred to in subparagraph (A) or (B)) and insured State branches of foreign banks, by the division of consumer affairs established by the Board of Directors of the Federal Deposit Insurance Corporation. *Id.*

The statute also presents a cross reference for additional guidance on definitions to the Banks and Banking portion of the United States Code. *Id.*; 15 U.S.C. § 1813 (2008) (listing its own definitions of the word "bank"). It is also worth noting that these definitions are immediately follow by a section entitled "Definitions relating to depository institutions." 15 U.S.C. § 1813(c) (2008). This reinforces the idea that the types of institutions being excluded are institutions of which "a substantial portion of the business of which institution consists of receiving deposits or exercising fiduciary powers. . . ." 69 Am. Jur. 2d Securities Regulation-Federal § 338. *See Miller* v. *U.S. Bank of Washington,* 865 P.2d 536, 541 (1994).

[138] *See* Morgan Stanley, Annual Report (Form 10–K), at 114, 148, 157, 202 (Nov. 30, 2007); The Goldman Sachs Group, Inc., Annual Report (Form 10–K), at 17–18, 80, 189–92 (Nov. 30, 2007).

[139] *FTC* v. *Rockefeller,* 441 F.Supp. 234 (S.D.N.Y. 1977).

[140] *Id.* at 236.

[141] *Id.* at 237. The banks contended that because they were exempt from the FTC jurisdiction, the subpoenas issued by the FTC were invalid. *Id.* at 240.

[142] *Id.* at 240.

[143] *Id.*

STATEMENT GERRY RAMM, PRESIDENT, INLAND OIL COMPANY, EPHRATA, WASHINGTON ON BEHALF OF THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA

Mr. RAMM. Thank you, Madam Chairman and Members of the Committee. I appreciate the opportunity to provide some insight on this extreme volatility and record-setting prices that we've seen in the recent months in the energy commodity markets.

I am with, and representing, the Petroleum Marketers Association of America. We are a national federation of 46 states and regional associations representing 8,000 independent fuel marketers and almost all the heating oil dealers in the Nation.

Excessive speculation on energy trading facilities is the fuel that is driving this runaway train in crude oil prices today. Excessive speculation is being driven by what Michael Masters, of Masters Capital Management, refers to as "index speculators," as compared to traditional speculators. "Index speculators" are institutional investors, such as corporate and government pension funds, sovereign wealth funds, and university endowments. These players are sometimes referred to as noncommercial or nonphysical players.

Index speculators have driven the demand, which does not correlate to the physical—current physical demand. Even though the rate of increase in China's demand, and, in fact, the world's trade—or, the world's rate of increase in demand, has slowed in recent years, the price of crude oil has almost tripled in that same period. Isn't it interesting that the largest increase in demand has been speculative trading, which has increased three times in recent years? Is the runup in prices due to physical demand or speculative demand created by these indexes?

This rise in crude-oil prices, which has reached $135 a barrel recently, has dragged with it every single refined petroleum product, especially heating oil and diesel. And, in May, heating oil and diesel went up as much as 80 cents a gallon in that 1 month. This price spike occurred while heating oil inventories remained at or near their 5-year average. While energy commodities continue to skyrocket, petroleum marketers and consumers are forced to pay excessively high energy prices.

We have come to the conclusion that excessive speculation on energy commodity markets has driven up the price of crude oil, and, consequently, all refined petroleum products, without the supply and-demand fundamentals to justify the recent runup.

Large purchases of crude oil futures contracts by speculators having consequence created an additional demand for oil, which drives up the price of the oil futures deliveries.

The October 2007 GAO report determined that futures market speculation could have an upward effect on prices. However, it was hard to quantify, because not all the numbers are reported to regulatory agencies. We must have full transparency. Speculators who have no contact with the physical commodity are trading on over-the-counter markets and foreign boards of trade which, due to a series of legal and administrative loopholes, are virtually opaque. Because these are unregulated trades, or "dark markets," there is no record. If these trades were manipulative in nature, it would increase the cost to the American consumer, it would increase the

cost of the commodity sold. Such trading would leave no public data, and there would be no fingerprints.

By passing the farm bill, you helped to take a first step in bringing transparency to the energy trading markets, but the CFTC has provided "no action" letters to foreign boards of trade, which subsequently now does not give CFTC regulatory authority over those trading platforms.

Why would the CFTC not want authority over the trading platforms that are operating within the United States and trading U.S.-delivered commodities? We suggest that Congress and administration consider closing the administrative foreign board of trades loophole by revoking the CFTC "no action" letters to oversee energy trading platforms, raising margin requirements or the necessary collateral for noncommercial entities, or so-called "nonphysical players." Currently, margins in the futures trading are as low as 3 percent for some contracts. To buy U.S. equities, margin requirements are a minimum of 50 percent, requiring noncommercial traders to have the ability to take some physical delivery of the product, to provide adequate funding for the CFTCs so that they can do their job, PMAA strongly supports the free exchange of commodity futures on an—open, well-regulated, and transparent exchanges that are subject to the rules of law and accountability.

Reliable futures markets are crucial to the entire petroleum industry. Let's make sure that these markets are competitively driven by the fundamentals of supply and demand. We and our customers need our public officials, including the Congress and the CFTC, to take a stand against the loopholes—or the loopholes that are artificially inflating energy prices.

I want to thank you for the opportunity to speak to you today, and I'm available for any questions that you may have.

[The prepared statement of Mr. Ramm follows:]

PREPARED STATEMENT OF GERRY RAMM, PRESIDENT, INLAND OIL COMPANY, EPHRATA, WASHINGTON ON BEHALF OF THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA

Honorable Chairman Inouye and Ranking Member Stevens and distinguished Members of the Committee, thank you for the invitation to testify before you today. I appreciate the opportunity to provide some insight on the extreme volatility and record setting prices seen in recent months on the energy commodity markets.

I am an Officer on the Petroleum Marketers Association of America's (PMAA) Executive Committee. PMAA is a national federation of 46 state and regional associations representing over 8,000 independent fuel marketers that collectively account for approximately half of the gasoline and nearly all of the distillate fuel consumed by motor vehicles and heating equipment in the United States. I also work for Inland Oil Company in Ephrata, Washington. My Dad started Inland Oil Company in 1946 after he returned from duty in World War II. Today we operate seven gas stations and convenience stores and we also supply fuel to eight independent dealers. Also, supporting my testimony here today is the New England Fuel Institute who represents over 1,000 heating fuel dealers in the New England area.

Last year, gasoline and heating oil retailers saw profit margins from fuel sales fall to their lowest point in decades as oil prices surged. The retail motor fuels industry is one of the most competitive industries in the marketplace, which is dominated by small, independent businesses. Retail station owners offer the lowest price for motor fuels to remain competitive, so that they generate enough customer traffic inside the store where station owners can make a modest profit by offering drink and snack items. Because petroleum marketers and station owners must pay for the inventory they sell, their lines of credit are approaching their limit due to the high costs of gasoline, heating oil and diesel. This creates a credit crisis with marketers'

banks, which creates liquidity problems and may force petroleum marketers and station owners to close up shop.

Excessive speculation on energy trading facilities is the fuel that is driving this runaway train in crude oil prices. The rise in crude oil prices in recent weeks, which reached $135.09 on May 22, 2008, has dragged with it every single refined petroleum product, especially heating oil. According to the Department of Energy, the cost of crude accounts for roughly 73 percent of the pump price, up from 62 percent in January 2008.[1] Wholesale heating oil prices from March 5, 2008–May 28, 2008 have risen from $2.97 to $3.81.[2] The spike comes despite warmer temperatures in the Northeast and the end of the heating oil season. Interestingly, Colonial Group Inc. which provides wholesale/retail petroleum fuels announced May 7, 2008, that it had 150,000 barrels of surplus heating oil available for auction. That same day heating oil futures set yet another record high with a 9.3 cent gain at $3.37 a gallon along with temperatures averaging in the upper 70s in the Northeast. The data doesn't add up.

Large purchases of crude oil futures contracts by speculators have created an additional demand for oil which drives up the prices of oil for future delivery. This has the same effect as the additional demand for contracts for delivery of a physical barrel today drives up the price for oil on the spot market. According to the Department of Energy, the amount of petroleum products shipped by the world's top oil exporters fell 2.5 percent last year, despite a 57 percent increase in prices.

According to a 2006 Senate Permanent Subcommittee on Investigations bipartisan report by Chairman Carl Levin (D-MI) and Ranking Member Norm Coleman (R–MN) entitled, *The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat,* "Several analysts have estimated that speculative purchases of oil futures have added as much as $20–$25 per barrel to the current price of crude oil, thereby pushing up the price of oil from $50 to approximately $70 per barrel." Who would have thought that crude oil futures would rise to over $130 a barrel?

Three weeks ago, Michael Masters, Managing Member and Portfolio Manager of Masters Capital Management, LLC, a hedge fund, argued before the Senate Committee on Homeland Security and Government Affairs that institutional investors are the cause of the recent run-up in commodity prices. Institutional investors are buying up all the commodity contracts (going long), especially energy commodities, and are not selling, thereby causing the demand for contracts to increase and putting further pressure on commodity prices. Institutional investors allocate a portion of their portfolios into commodities since they are posting solid returns rather than traditional investments like stocks and bonds.

Since commodities futures markets are much smaller than equity markets, billions invested into commodity markets will have a far greater impact on commodity prices than billions of dollars invested in equity markets. Masters stated that while some economists point to China's demand for crude oil as the cause for the recent rise in energy costs, he disclaims that assumption. In fact, Masters' testimony highlights a Department of Energy report that annual Chinese demand for petroleum has increased over the last 5 years by 920 million barrels. Yet, over the same five-year period, index speculators' demand for petroleum futures has increased by 848 million barrels, thus the increase in demand from institutional investors is almost equal to the increase in demand from China! Wouldn't this demand by institutional investors have some effect on prices?

Also, many economists and financial analysts report that the weak dollar has put pressure on crude oil prices. While the weak dollar explanation is partly true because crude oil is denominated in dollars which reduces the price of oil exports for producers, leading them to seek higher prices to make up for the loss, this does not justify crude oil's move beyond $130 a barrel. On May 1, 2008, the front month NYMEX WTI crude oil contract closed just under $113 per barrel. Three weeks later the same front month NYMEX WTI contract was trading at over $132 per barrel. In that same period of time the dollar traded between $1.50 to $1.60 against the Euro. While the Euro strengthened against the dollar, it doesn't justify that crude oil should have increased $19. There were no significant supply disruptions during this time period.

U.S. destined crude oil contracts could be trading DAILY at a rate that is multiple times the rate of annual consumption, and U.S. destined heating oil contracts could be trading daily multiple times the rate of annual consumption. Imagine the impact on the housing market if every single house was bought and sold multiple times

[1] Energy Information Administration, "Gasoline and Diesel Fuel Update," April 2008.

[2] Energy Information Administration, "U.S. No. 2 Heating Oil Wholesale/Resale Prices," March 5–May 28, 2008.

every day. An October 2007 Government Accountability Office report, *Trends in Energy Derivatives Markets Raise Questions about CFTC's Oversight,* determined that futures market speculation could have an upward effect on prices; however, it was hard to quantify the exact totals due to lack of transparency and recordkeeping by the CFTC.

To be able to accurately "add up" all of the numbers, you must have full market transparency. This is perhaps the biggest barrier to obtaining an accurate percentage calculation of the per barrel cost of non-commercial speculative investment in crude oil, natural gas and other energy products. Much of the non-commercial (*i.e.,* speculators that have no direct contact with the physical commodity) involvement in the commodities markets is isolated to the over-the-counter markets and foreign boards-of-trade, which, due to a series of legal and administrative loopholes, are virtually opaque.

PMAA would like to thank Congress for passing the Farm Bill (H.R. 2419), specifically, Title XIII, which will bring some transparency to over-the-counter markets. However, the Farm Bill is only a first step.

What the Farm Bill language does not do is repeal a letter of "no action" issued by the CFTC to the London based International Petroleum Exchange (IPE) which was subsequently purchased by the Intercontinental Exchange (ICE). The letter of no action was issued since the IPE was regulated by the United Kingdom's Financial Services Authority (FSA), which theoretically exercised comparable oversight of the IPE as CFTC did to NYMEX. Recently, however, whether or not the FSA exercises "comparable oversight" was brought into question by CFTC Commissioner Bart Chilton. Congress needs to investigate whether or not oversight by foreign regulators is "comparable." Currently, FSA doesn't monitor daily trading to prevent manipulation, publish daily trading information, or impose and enforce position limits that prevent excessive speculation.

ICE is the exchange most often utilized by those who exploit the Enron Loophole. ICE is a publicly traded exchange whose shareholders are primarily investment funds. In recent years ICE's trading volume has exploded at the expense of the regulated NYMEX. According to the Securities and Exchange Commission filings, traders on ICE made bets on oil with a total paper value of $8 trillion in 2007, up from $1.7 trillion in 2005.[3] ICE purchased IPE and will continue to claim exemptions on various contracts whether or not the Farm bill becomes law since they effectively have a "get out of jail free card."

While PMAA applauds the recent CFTC announcement that it will expand information sharing with the U.K.'s Financial Services Agency and ICE Futures Europe to obtain large trader positions in the West Texas Intermediate crude oil contract, more needs to be done to prevent and deter market manipulation on all foreign boards of trade.

Congress and the Administration might also consider:

1. Closing the Administrative Foreign Boards-of-Trade Loophole via review or elimination of CFTC "no action letters" to overseas energy trading platforms. PMAA supports any legislative remedy that would ensure that all off-shore exchanges be subject to the same level of oversight and regulation as domestic exchanges such as the NYMEX when those exchanges allow U.S. access to their platforms, trade U.S. destined commodities, or are owned and operated by U.S.-based companies.

2. Raising margin requirements (or necessary collateral) for non-commercial entities or so-called "non-physical players," *i.e.,* commodities traders and investors that do not have the ability to take physical possession of the commodity, or otherwise incurs risk (including price risk) associated with the commodity either in connection with their business or that of a client. In other words, anyone who does not meet the definition of "eligible commercial entity" under 7 U.S.C. § 1a(11). Currently, margin requirements in futures trading are as low as 3 percent for some contracts. To buy U.S. equities, margin requirements are a minimum of 50 percent.

3. Requiring non-commercial traders (*e.g.,* financial institutions, insurance companies, commodity pools) to have the ability to take physical delivery of at least some of the product. (Rep. John Larson (D–CT) is considering such a proposal).

4. Banning from the market any participant that does not have the ability to take direct physical possession of a commodity, is not trading in order to manage risk associated with the commodity, or is not a risk management or hedging

[3] Herbst, Moira; *Speculation—but Not Manipulation: Financial News,* Business Week, May 30, 2008.

service (again, anyone that does not meet the statutory definition of "commercial entity" under 7 § U.S.C. 1a(11).

5. Significantly increase funding for the CFTC. The FY 2009 President's budget recommendation is for $130 million. While this is an increase from previous years, CFTC staff has declined by 12 percent since the commission was establish in 1976, yet total contract volume has increased over 8,000 percent. Congress should appropriate sufficient funding to keep up with the ever changing environment of energy derivatives markets.

We and our customers need our public officials, including those in Congress and on the CFTC, to take a stand against excessive speculation that artificially inflates energy prices. PMAA strongly supports the free exchange of commodity futures on open, well regulated and transparent exchanges that are subject to the rule of laws and accountability. Many PMAA members rely on these markets to hedge product for the benefit of their business planning and their consumers. Reliable futures markets are crucial to the entire petroleum industry. Let's make sure that these markets are competitively driven by supply and demand.

Thank you again for allowing me the opportunity to testify before you today.

Senator CANTWELL. Thank you, Mr. Ramm.

Fourth, we'll hear from Lee Ann Watson, Deputy Director of Division of Investigation, Office of Enforcement, for the Federal Energy Regulatory Commission. And Ms. Watson helped develop and implement FERC's anti-manipulation authority, which is the same authority that we have given to the Federal Trade Commission as it relates to physical oil markets.

Ms. Watson, welcome.

STATEMENT OF LEE ANN WATSON, DEPUTY DIRECTOR, DIVISION OF INVESTIGATIONS, OFFICE OF ENFORCEMENT, FEDERAL ENERGY REGULATORY COMMISSION (FERC)

Ms. WATSON. Thank you.

First, let me apologize for my voice. I woke up with a cold this morning, so bear with me.

Senator CANTWELL. Thank you. If you could just pull the microphone a little closer——

Ms. WATSON. A little closer?

Senator CANTWELL.—that'll help you and less——

Ms. WATSON. Is this a little——

Senator CANTWELL.—strain on your voice.

Ms. WATSON.—better?

Senator CANTWELL. Yes, thank you.

Ms. WATSON. Thank you.

Madam Chair and Members of the Committee, I thank you for inviting me to testify today. I am here today to discuss the experience of the Federal Energy Regulatory Commission, or FERC, in implementing the statutory authority granted to FERC in the Energy Policy Act of 2005, or as—I will refer to it as EPAct—to prohibit manipulation in wholesale electric energy and natural gas markets.

In particular, this experience may be useful, as it may relate to similar authority recently granted to the Federal Trade Commission, or the FTC. I note, however, that I could not address market manipulation in the oil and petroleum products markets. FERC does not have jurisdiction over those markets or expertise in how such manipulation might be prevented by the FTC.

I also note that I appear before you today as a staff witness, and I do not represent the views of the Commission or any individual commissioner.

EPAct added new provisions in both the Federal Power Act and the Natural Gas Act to prohibit manipulation in FERC jurisdictional markets for wholesale sales of electric energy and natural gas and electric transmission and natural gas transportation. Because the statutory authority was not self-implementing, however, upon passage of EPAct, in August 2005, the FERC staff immediately began work in preparing a Notice of Proposed Rulemaking, or NOPR, which was issued on October 20, 2005. After reviewing and considering comments on the NOPR, the FERC issued, on January 19, 2006, its final anti-manipulation regulations. These new regulations, one for natural gas and one for electricity, closely model Rule 10b–5 of the Securities Exchange Act of 1934, pursuant to Congress's direction that the prohibited manipulative activity should be consistent with the prohibited activity in Section 10b of the Securities Exchange Act. That direction was an important factor in the FERC's ability to quickly implement its anti-manipulation regulations and authority.

The new anti-manipulation regulations promulgated by FERC are very broad, just like 10b–5, and are meant to be a catchall fraud provision, just as Rule 10b–5 has been interpreted in the securities context. And while FERC's anti-manipulation regulations seek to draw on the large body of security case law under Section 10b and Rule 10b–5, FERC also recognized that the securities case law could only be applied as appropriate in the circumstances of each case because of the differences in the missions between the SEC and FERC. For example, the SEC, whose mission is to assure adequate disclosure in the financial markets and to protect investors, does not have a duty to assure that the price of a security is just and reasonable. The FERC, on the other hand, has as a core mission to assure the just and reasonable prices for wholesale sales of electricity and natural gas and for the transmission and transportation of those products. Despite these differences, the securities case law is available by analogy, and thus provides guidance and certainty to the market participants who wish to avoid violating the FERC's anti-manipulation regulations within the framework of the FPA and the NGA.

In developing and adopting the anti-manipulation regulations under the new EPAct provisions, FERC was not writing on an entirely clean slate, since, prior to EPAct, it did have regulations in place to prohibit market manipulation. In 2003, in the aftermath of the California energy crisis, FERC had required all market-based rate sellers to incorporate, in their tariffs or authorizations, a rule prohibiting market manipulation. However, because the breadth and application of the anti-manipulation provisions contained in EPAct were substantially greater, the FERC decided to rescind its prior provisions.

In addition to implementing its new anti-manipulation rules under EPAct quickly, FERC also promptly issued a policy statement on enforcement, highlighting the factors it would take into account in determining civil penalties, which were also enhanced under EPAct. In this regard, FERC also looked to other agencies

with more experience, such as the Department of Justice, the CFTC, and the SEC, and modeled the policy statement on enforcement on prior proven policies of its sister agencies.

The FERC has not hesitated to put its new anti-manipulation authority to work to protect consumers. In July 2007, less than 2 years after EPAct was enacted, the FERC issued two orders to show cause for alleged market manipulation, seeking to oppose civil penalties in excess of $450 million, and this includes the Amaranth case, which has been noted earlier today. Further, since the time that EPAct provided FERC with the increased civil penalty authority, it has approved 15 settlements which include civil penalties of over $52 million.

This concludes my remarks, and I would be happy to answer any questions the Members of the Committee might have.

[The prepared statement of Ms. Watson follows:]

PREPARED STATEMENT OF LEE ANN WATSON, DEPUTY DIRECTOR, DIVISION OF INVESTIGATIONS, OFFICE OF ENFORCEMENT, FEDERAL ENERGY REGULATORY COMMISSION (FERC)

Madam Chair and Members of the Committee:

Thank you for inviting me to testify today. My testimony addresses the Federal Energy Regulatory Commission's (FERC) implementation of the aspects of the Energy Policy Act of 2005 (EPAct 2005) provisions prohibiting manipulation of wholesale electric energy and natural gas markets. I appear before you today as a staff witness and do not represent the views of the Commission or any individual Commissioner.

At the outset, I should note for the Committee's information that I am not prepared to discuss whether there is or has been manipulation of oil or petroleum markets nor am I able to discuss crude oil or gasoline prices. With respect to oil and petroleum, FERC's jurisdiction is very limited. FERC has jurisdiction only over ratemaking of oil pipeline transportation in interstate commerce under the authority of the Interstate Commerce Act and the Department of Energy Organization Act of 1977, 42 U.S.C. § 7101 et seq. FERC has no jurisdiction over, and therefore no authority to investigate, the prices charged for oil, gasoline, diesel, or heating oil, or the markets where those and other oil and petroleum products are traded.

FERC's primary mission is to ensure "just and reasonable" rates for certain wholesale sales of electric energy and natural gas in interstate commerce and electric transmission and natural gas transportation in interstate commerce. FERC's efforts to prohibit manipulation of the wholesale sales of electric energy and natural gas markets began in earnest in November 2003, prior to EPAct 2005. At that time, the FERC adopted the Market Behavior Rules, including Market Behavior Rule 2.[1] In contrast to the FERC's current broad EPAct 2005 anti-manipulation regulations, which I will discuss momentarily, Market Behavior Rule 2 was limited in scope and application; it applied to certain sales and sellers of electricity and natural gas. Notwithstanding its limitations, Market Behavior Rule 2 and its companion rules were an important first step in an evolving enforcement program at FERC that balanced the need for clearly delineated "rules of the road" for market participants without unduly impairing FERC's ability to address new and unforeseen abuses.

On August 8, 2005, EPAct 2005 became law and significantly supplemented the Commission's enforcement authorities. Three enforcement tools in particular provided FERC with the ability to more adequately police jurisdictional electric and natural gas markets and sanction manipulative behavior in those markets. First, EPAct 2005 amended the FPA and NGA to grant broad statutory authority to prohibit fraud and market manipulation. Second, it granted robust civil penalty authority to deter and punish violations of FERC orders, rules and regulations. Third, it provides authority to seek a court order to bar individuals found to have violated FERC's new anti-manipulation authority from acting as an officer or director of a

[1] *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations,* "Order Amending Market-Based Rate Tariffs and Authorizations," 105 FERC ¶ 61,218 (2003), *reh'g denied,* 107 FERC ¶ 61,175 (2004); *Amendments to Blanket Sales Certificates*, 105 FERC ¶ 61,218 (2003), *reh'g denied,* 107 FERC ¶ 61,174 (2004).

jurisdictional entity, or engaging in FERC-jurisdictional transactions. I discuss these new authorities in further detail below.

In sections 315 and 1283 of EPAct 2005, Congress added section 4A to the Natural Gas Act (NGA) and section 222 to the Federal Power Act (FPA), respectively.[2] These sections prohibit "any entity," not only those traditional energy companies regulated by FERC, from the use or employment of "any manipulative or deceptive device or contrivance," as those terms are used in section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), in connection with the purchase or sale of natural gas, electric energy, or transportation or transmission services subject to FERC's jurisdiction.[3] Although sections 315 and 1283 of EPAct were not self-implementing, by modeling them on section 10(b) of the Exchange Act, and explicitly directing that certain terms be used as in section 10(b), Congress provided FERC a clear model to follow—SEC Rule 10b–5—in prohibiting market manipulation.[4]

On October 20, 2005, only 2 months after the passage of EPAct 2005, FERC took the first public step toward implementing the anti-manipulation fraud authority when it issued a Notice of Proposed Rulemaking (NOPR).[5] FERC was able to act quickly in part because FERC staff had been studying SEC Rule 10b–5 in anticipation of the passage of EPAct 2005. Upon the passage of EPAct 2005, FERC staff met with senior enforcement staff from the SEC and held several subsequent conference calls with them to aid in FERC's understanding of the model upon which it would propose its anti-manipulation rule. Thirty parties filed comments and nine parties filed reply comments to the NOPR, representing a diverse group of industry stakeholders. Overwhelmingly, commenters were supportive of our efforts to implement well-developed, clear and fair rules modeled on SEC Rule 10b–5 because the approach provided FERC, and industry, the opportunity, where appropriate, to make use of the significant body of case law that has developed under Exchange Act section 10(b) and SEC Rule 10b–5. In the NOPR, FERC noted the overlap between its previously adopted Market Behavior Rule 2 and the proposed EPAct 2005 anti-manipulation regulations. FERC said that it would retain Market Behavior Rule 2 pending the promulgation of a final EPAct 2005 regulation so as to ensure there would be no gap in FERC's prohibition of market manipulation. FERC also said, however, that it would seek comment on whether it should revise or rescind Market Behavior Rule 2.

In November 2005, FERC proposed to rescind Market Behavior Rule 2 and the analogous gas regulation once it issued new anti-manipulation provisions of EPAct 2005.[6] FERC noted that rescission of Market Behavior Rule 2 would simplify FERC's rules by avoiding duplicative regulation, and in so doing, reduce regulatory uncertainty by assuring that all market participants are held to the same standard. FERC explained that rescinding the Market Behavior Rules was consistent with Congressional intent in EPAct 2005, which provided FERC explicit anti-manipulation authority and a clear model to follow in implementing that authority. FERC was concerned that having two general anti-manipulation rules, differing in scope and application, would result in significant regulatory uncertainty without offering any additional protection for customers. After careful review of the 21 comments and four reply comments in response to the November 2005 order, which were mostly supportive of FERC's objective to bring greater clarity to its rules and regulations, FERC exercised its discretion and rescinded Market Behavior Rule 2 in February 2006, approximately a month after the effective date of the new EPAct 2005 anti-manipulation regulations.[7]

As mentioned earlier, in EPAct 2005, Congress added section 4A to the NGA and section 222 to the FPA. These sections prohibit "any entity" from the use or employment of "any manipulative or deceptive device or contrivance," as those terms are used in section 10(b) of the Exchange Act, in connection with the purchase or sale of natural gas, electric energy, or transportation or transmission services subject to FERC's jurisdiction.

On January 19, 2006, just 5 months after the passage of EPAct 2005, FERC implemented section 4A to the NGA and section 222 to the FPA and promulgated its final EPAct 2005 anti-manipulation regulations, which are codified in Part 1c of Title 18 of the Code of Federal Regulations.[8] Consistent with Congressional intent,

[2] Energy Policy Act of 2005, Pub. L. No. 109–58, 119 Stat. 594 (2005) *et seq.;* 15 U.S.C. §§ 717 *et al.* (2000); 16 U.S.C. §§ 791 *et al.* (2000).
[3] Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (2000).
[4] 17 C.F.R. § 240.10b–5 (2007).
[5] *Prohibition of Energy Market Manipulation,* 113 FERC ¶ 61,067 (2005) (NOPR).
[6] *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations,* 113 FERC ¶ 61,190 (2005).
[7] *Order Revising Market-Based Rate Tariffs and Authorizations,* 114 FERC ¶ 61,165 (2006).
[8] 18 C.F.R. § 1c (2007).

the scope of application of Part 1c is not limited to FERC jurisdictional entities. Instead, Part 1c is a "catch-all" provision, applying to any entity that perpetrates a fraud, with the requisite scienter, in connection with the purchase or sale of natural gas or electric energy or transportation or transmission services subject to FERC's jurisdiction. The issues raised by commenters to the NOPR did not require substantive changes to the proposed rule because the preamble to the final rule, Order No. 670, deals with the issues raised and provides clarity and guidance as to how the rule will operate.[9] For example, in Order No. 670, FERC recognizes the differences in mission between the FERC and the SEC—that is, the SEC does not have a duty to assure that the price of a security is just and reasonable just as FERC's duty is not to protect purchasers though a regime of disclosure. Despite these differences in mission, however, FERC recognized that natural gas and power markets, like securities markets, are susceptible to fraud and market manipulation.

Part 1c gives FERC an important tool to ensure that the markets subject to its jurisdiction are well-functioning, and represents an important step toward assuring that customers are properly safeguarded from acts of market manipulation while providing regulatory certainty to market participants. Part 1c became effective upon its publication in the Federal Register on January 26, 2006. Two enforcement actions, one under Part 1c and one under its predecessor Market Behavior Rule 2, where FERC made preliminary findings of market manipulation involving traders' unlawful actions in natural gas markets and proposed civil penalties totaling $458 million, demonstrate that FERC is dedicated to ensuring the markets subject to its jurisdiction are well-functioning and free from fraud.[10] FERC's investigative activities are not limited to these two matters, but FERC's regulations prohibit staff from discussing any other potential investigative matters.

In EPAct 2005, Congress also granted FERC enhanced authority to assess civil penalties for violations of the Federal Power Act, Natural Gas Act and the Natural Gas Policy Act in three important ways. First, Congress expanded FERC's FPA civil penalty authority to cover violations of any provision of Part II of the FPA, as well as of any rule or order issued there under.[11] Second, Congress extended FERC's civil penalty authority to cover violations of the NGA or any rule, regulation, restriction, condition, or order made or imposed by FERC under NGA authority.[12] Third, Congress established the maximum civil penalty FERC may assess under the NGA, NGPA, or Part II of the FPA as $1,000,000 per violation for each day that it continues.[13] Since January 1, 2006, FERC has employed its new civil penalty authority, which was not made retroactive by EPAct 2005, in 15 cases resulting in a total of over $52 million in civil penalties and tailored compliance plans.

The third tool EPAct 2005 provided FERC is the ability to seek an order of a Federal district court to prohibit, conditionally or unconditionally, and permanently or for such period of time as the court determines, any individual who is engaged or has engaged in practices constituting a violation of FERC's EPAct 2005 anti-manipulation regulations from: (1) acting as an officer or director of a natural gas company; or (2) engaging in the business of the purchasing or selling of natural gas or electric energy, or the purchasing or selling of transmission services subject to FERC's jurisdiction. This is a particularly useful tool where, for example, FERC determines that it is necessary to seek the removal of a rogue trader that was found to have violated Part 1c as an individual. A similar provision is contained in the FPA.

Prior to the promulgation of FERC's new anti-manipulation rule, but on the same day in October 2005 when FERC issued its proposed anti-manipulation rule NOPR, FERC issued its Policy Statement on Enforcement to provide the public with guidance and regulatory certainty regarding FERC's enforcement of the statutes, orders, rules and regulations it administers.[14] Among other things, the Policy Statement on Enforcement details the FERC's penalty assessment process. Shortly after the issuance of the Policy Statement on Enforcement, FERC's instituted a No-Action Letter Process whereby regulated entities can seek informal staff advice regarding whether a transaction would be viewed by staff as constituting a violation of certain

[9] *Prohibition of Energy Market Manipulation,* III FERC Stats. & Regs., Regulation Preambles P31,202 (2006) (Order No. 670).

[10] *See Energy Transfer Partners, L.P.,* 120 FERC P 61,086 (2007) (Market Behavior Rule 2); *Amaranth Advisors L.L.C.,* 120 FERC P 61,085 (2007) (Anti-Manipulation Rule).

[11] 16 U.S.C. § 825o–1 (2000) (as amended by EPAct 2005, § 1284(e)); 16 U.S.C. § 823b (2000).

[12] 15 U.S.C. § 717t–1 (2000) (added by EPAct 2005, § 314(a)(1)).

[13] *Supra* notes 11 and 12; 15 U.S.C. § 3414(b)(6) (2000) (as amended by EPAct 2005, § 314).

[14] *Enforcement of Statutes, Orders, Rules, and Regulations,* 113 FERC ¶ 61,068 (2005).

orders or regulations.[15] In both Orders, FERC drew on the best practices of other economic regulators including the Department of Justice, SEC and CFTC. As of May 15, 2008, following a public conference where stakeholders were invited to comment on aspects of FERC's enforcement program, FERC issued a Revised Policy Statement on Enforcement which builds on the October 2005 statement.[16] Additionally, in December 2006, FERC issued a policy statement regarding the process for assessing civil penalties, which provides a comprehensive review of the statutory requirements associated with the imposition of civil penalties under Parts I and II of the FPA, the NGA, and the NGPA.[17]

In conclusion, I want again to thank the Committee for this opportunity to testify today on an important aspect of the FERC's enforcement program. I would be happy to answer any questions members of the Committee may have.

* * *

In sum, below are the milestones in the implementation timeline for the EPAct 2005 anti-manipulation regulations:

1. Pre-Passage of EPAct 2005: FERC staff conducts due diligence on SEC and CFTC anti-manipulation rules and precedent.
2. August 8, 2005: EPAct 2005 becomes law and FERC staff forms an anti-manipulation rule drafting team.
3. September 14, 2005: FERC staff meets with SEC staff to discuss SEC's experience with Rule 10b–5.
4. October 20, 2005: FERC issues its NOPR to prohibit energy market manipulation and FERC issues its first Policy Statement on Enforcement to provide guidance and regulatory certainty regarding FERC's enforcement program.
5. November 18–December 30, 2005: FERC receives and reviews thirty comments and nine reply comments on the NOPR.
6. January 19, 2006: FERC promulgates its anti-manipulation rules by amending its regulations to implement the anti-manipulation authority granted in EPAct 2005.
7. January 26, 2006: FERC's anti-manipulation regulations became effective.

Senator CANTWELL. Thank you very much. And, again, we appreciate you being here, Ms. Watson.

We're now going to hear from Mark Cooper, Director of Research at Consumer Federation of America.

We appreciate you being here to testify today, Mr. Cooper.

STATEMENT OF DR. MARK N. COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA

Dr. COOPER. Thank you, Madam Chairwoman, Members of the Committee.

The speculative bubble in petroleum markets has cost the average American household about $1,500 in increased gasoline, natural gas, and electricity expenditures in the 2 years since the Senate Permanent Committee on Investigations first called attention to the problem. The Senate knew about this problem 2 years ago. It has cost the economy well over half a trillion dollars in those 2 years.

Worse still, it is now clear that the commodities futures markets have ceased to play their proper role of helping to smooth the functioning of physical markets for vital commodities like energy and food. Instead, they have become engines of speculation that feed volatility, amp up volume, and increase risk, driving prices up and

[15] *Informal Staff Advice on Regulatory Requirements,* 113 FERC ¶ 61,174 (2005).
[16] *Enforcement of Statutes, Orders, Rules, and Regulations,* 123 FERC ¶ 61,156 (2008) (Revised Policy Statement on Enforcement) (superseding *Enforcement of Statutes, Orders, Rules, and Regulations,* 113 FERC ¶ 61,068 (2005)).
[17] *Process for Assessing Civil Penalties,* 117 FERC ¶ 61,317 (2006).

driving commercial traders out of these markets. Unfortunately, the CFTC and the FERC have failed to protect the public, because they were slow to recognize the problem are not looking for the real causes, for they look for a narrow set of abuses, adopting existing case law, they ignore the much broader flaws in the commodities futures markets. Energy commodities, in particular, are vulnerable to abuse, but they are traded in markets that are either totally unregulated or inadequately regulated. Prices are well above the costs of production. Risk premiums are high and rising. The market structure and behaviors are biased in favor of higher prices and against consumers. There is a pervasive pattern of past abuses, including manipulation of large positions, lack of transparency, structural advances enjoyed by large traders, the exercise of market power, insider trading, self-dealing, and trading practices that accelerate market trends.

Energy commodity markets are a recent phenomenon, and they have been plagued by inefficiency, manipulation, and rampant speculation throughout much of their history, creating additional risk, which requires costly management, enriches the speculators and arbitrageurs, but does physical traders and consumers no good whatsoever. These markets need to be overhauled from top to bottom.

It would be reassuringly simple if we could just blame the current speculative bubble on the blind ignorance, indifference, and ineptitude of the regulatory agencies, "just fire the commissioners and clean the problem up." The recent proposals that have been put on the table are baby steps that will not solve the problem. There are more fundamental problems that must be addressed.

We have made it so easy to play in financial markets that investments in long-term productive assets are unattractive. We must turn down the volume by imposing more stringent conditions on these financial markets. We must not only close the Enron loophole which allowed the vast swath of unregulated trading to take place, but we also must ensure vigorous enforcement of registration and reporting.

We must take back the authority we have given to foreign exchanges and stop abandoning authority to private actors. Large traders should be required to register and report their entire positions across all commodity markets. Without comprehensive reporting, there will always be room for mischief that is out of the sight of the regulator. Registration reporting should trigger scrutiny to ensure the good character, integrity, and competence of traders. Failure to comply with these regulations should result in mandatory jail terms. Fines are not enough to dissuade abuse in these commodity markets, because there is, just, so much money to be made that people will keep trying and trying. You have to throw the bad guys in jail. That's the only way you'll get the attention of all the people who know they can make a fortune by manipulating these markets.

More broadly, we need to restore the balance between speculation and productive investment. Margin requirements and reserve requirements in organized exchanges are a fraction of the margin requirements on stocks. If it is cheaper to put your money into speculation, why bother with real, productive investment? The

margin requirements for commodity trading among noncommercial traders should be 50 percent higher than the margin requirements for investment in stocks. They should be more lenient for physical traders and commercial traders who really need to get these commodities into the tanks and to consumers.

We must level the playing field between long-term productive investment and short-term speculative gains, with a tax on short-term capital gains between 33 and 50 percent. This will make holding productive assets for long periods as attractive as flipping short-term financial paper.

If we do not do more than the approaches that are on the table, we will continue to lurch from crisis to crisis. The halfhearted reaction of the CFTC and the FERC are the regulatory equivalent of FEMA's reaction to Hurricane Katrina, too low and too slow because the agency does not adequate the magnitude of the disaster. American consumers are suffering needlessly from the speculative bubble in vital necessities. It is time for thorough reform and reregulation of financial commodities markets so that they can serve the American people, not oppress them.

Thank you.

[The prepared statement of Dr. Cooper follows:]

PREPARED STATEMENT OF DR. MARK COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA

Mr. Chairman and Members of the Committee,

My name is Dr. Mark Cooper. I am Director of Research at the Consumer Federation of America. I greatly appreciate the opportunity to testify today on the immense burden that the speculative bubble in commodities is placing on American households. Congressional studies, like that prepared by the Senate Permanent Subcommittee on Investigations, committee on Homeland Security [1] and Governmental Affairs [2] and industry analyses have become convinced that speculation is contributing to skyrocketing energy prices—by adding as much as $30 per barrel or more. Natural gas prices have been afflicted by a speculative premium of a similar order of magnitude.[3] Since the Senate Permanent Subcommittee on Investigations first flagged this problem 2 years ago, the speculative bubble in the energy complex has cost the economy more than $500 billion—*i.e.,* half a trillion dollars. Expenditures for household energy have more than doubled in the past 6 years and speculation has played a significant part in that run up.[4] In the past 2 years, the speculative bubble has cost consumers over $1,500.

The national economy and households budgets are being clobbered by these rising energy prices and it is not just supply and demand that are to blame. Our analysis shows that there is a powerful interaction between physical market problems and financial market problems that creates a vicious, anti-consumer price spiral (see *Exhibit 1*). In today's hearing I focus on the financial market aspect.

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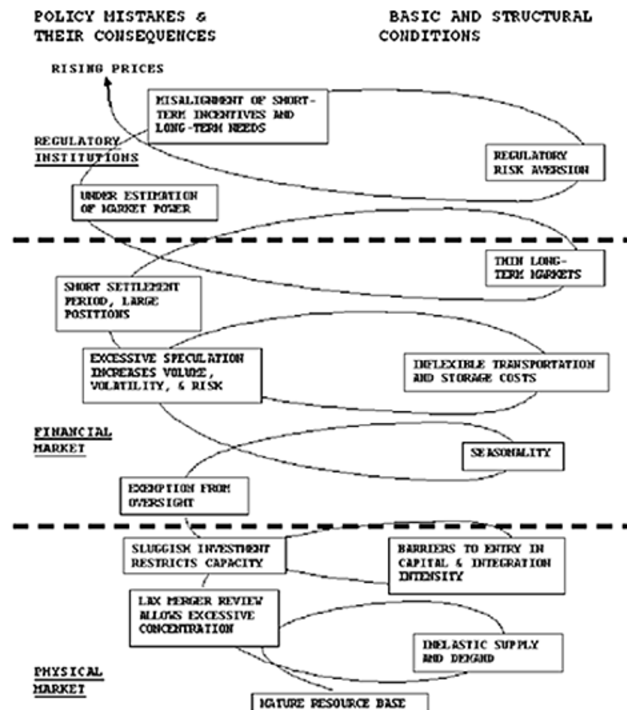
[1] Senate Permanent Subcommittee on Investigations, Committee on Homeland Security, *The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat* (June 27, 2006).

[2] Akira Yanagisawa, *Decomposition Analysis of the Soaring Crude Oil Prices: Analyzing the Effects of Fundamentals and Premium* (Institute of Energy Economics, March 2008; Robert J. Shapiro and Nam D. Pham, *An Analysis of Spot and Futures Prices for Natural Gas: The Roles of Economic Fundamental, Market Structure, Speculation and Manipulation* (August, 2006).

[3] Mark Cooper, The Role of Supply, Demand and Financial Commodity Markets in the Natural Gas Price Spiral, A report Prepared for the Midwest Attorney General Natural Gas Working Group (Illinois, Iowa, Missouri, and Wisconsin (March, 2006).

[4] Statement of Dr. Mark Cooper, "Consumer Effects of Retail Gas Prices," Judiciary Committee Antitrust Task Force, U.S. House of Representatives, May 7, 2008

Exhibit 1: Physical, Financial and Regulatory Factors in the Energy Price Spiral



Source: Mark Cooper, "The Failure of Federal Authorities to Protect American Energy Consumers from Market Power and Other Abusive Practices," *Loyola Consumer Law Review,* 19:4 (2007), p. 318.

The Problem of Hyper-Speculation in Energy Commodity Markets

In March of 2006 I published a report for the Attorneys General of Illinois, Iowa, Missouri and Wisconsin that concluded that all was not right in natural gas financial markets.

> Thus, while there is a spiral of upward pressure on prices radiating from the physical market and filtered through regulation, this analysis shows that the financial commodity markets may be dramatically accentuating the problem of high and volatile prices.
>
> Defenders of the financial markets want to blame the whole problem on the physical markets and even claim that traders will help solve the problem. But the evidence suggests that the financial commodity market bears at least some of the blame for pushing prices up. Today, the evidence that the financial commodity markets are significantly accelerating price increases in natural gas markets is circumstantial, but quite strong.
>
> The overall pattern of prices supports the proposition that they have run up beyond anything that is justified by the problems in the physical market.

- We have a commodity that is vulnerable to abuse, in a new market that has been under-regulated from its birth.
- Public policy adopted in 2000 further reduced regulation and opened the door to counterproductive, if not outright manipulative, behaviors and pushed prices higher.
- We have a clear theory about how consumers could be hurt in this market.
- The problem is that both the structure of the market and the behaviors of market players are biased in favor of higher prices and against consumers.

- We have evidence at the micro levels of a pervasive pattern of past abuses and rumors about suspicious behavior in the current market.[5]

  There are several ways in which financial markets may be magnifying the upwardly volatile spiral of prices and contribute to the ratchet:

  Financial markets thrive on volatility and volume, but volatility and volume have costs. Producers of gas demand to be paid a higher premium to bring their gas to market sooner rather than later. Traders demand to be rewarded for the risks they incur, risks that are increased by the trading process itself.

  The influx of traders fuels volatility and raises concerns about abusive or manipulative trading practices.

  Econometric analyses of the natural gas markets in recent years raise important questions as to how well the natural gas markets work. Given the uncertainty about the functioning of these markets, the claim that the market price is always right because it's the market price should be questioned:

  The economic analysis does not support the claim that these markets operate efficiently to establish prices.

  Risk premiums, which raise the price substantially (10 to 20 percent), are high and rising.

  Prices are well above the underlying costs of production.

  The operation of financial markets is no accident. Trading reflects the rules that are established—by law and through self-organization. The most troubling part about natural gas trading is that policymakers really have no clue about what goes on:

  The majority of transactions take place in markets that are largely unregulated.

  These over-the-counter markets, reported in unaudited, unregulated indices, are a major factor in setting the price of natural gas. And these unaudited, unregulated markets have behaved very poorly in recent years, with numerous instances of misreporting of prices.

  Even where there is light-handed regulation, the rules are inadequate to protect the public:

  Players in the natural gas markets can hold very large positions without having to disclose the size of their positions to any regulatory authority, and a small number of large players can influence the price that consumers pay in a very short period of time and under circumstances that place the consumer at risk.

  Index prices are often based on a small number of self-reported transactions and there are no mechanisms for determining if such transactions represent an accurate sampling of the natural gas market. When even the hint of accountability was imposed by merely being asked to certify the veracity of reported transactions, traders stopped reporting.[6]

  There has been a failure of public policy at every level to build a system that protects the public. The structure of the physical markets induces conduct that has created and is sustaining a tight market. The structure of the financial commodities markets induces conduct that magnifies upward pressures on prices . . .

  The financial markets are not only largely unregulated, they are structured in such a way that there are a large number of small buyers who have weakened incentives and limited ability to resist price increases facing a small number of large sellers who have a strong incentive and a much greater ability to hold out for higher prices. Holding out on the supply side may simply mean buying and holding assets in the ground or positions in the futures market and waiting for buyers who need the commodity to blink.

  Most troubling is the fact that many of the impacts of many of the legislative and regulatory policies that have worked to the detriment of consumers were predictable and preventable, given the nature of the commodity and the type of market that Congress and the regulatory agencies in Washington created.[7]

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[5] Cooper, Mark Cooper, *The Role of Supply, Demand and Financial Commodity Markets in the Natural Gas Price Spiral,* p. 88.

[6] Cooper, Mark Cooper, *The Role of Supply, Demand and Financial Commodity Markets in the Natural Gas Price Spiral,* p. 9.

[7] Cooper, Mark Cooper, *The Role of Supply, Demand and Financial Commodity Markets in the Natural Gas Price Spiral,* p. 89.

When the Federal Energy Regulatory Commission got wind of the report, without ever talking to us about it, they ridiculed it at an open meeting of the Commission. The Chairman of the FERC, reflecting the party line of the Administration, insisted that all the price gyrations were the result of market fundamentals. He was absolutely certain that the FERC had its finger on the pulse of the commodity markets. He was absolutely wrong.[8] At the very moment he was rejecting our analysis, unbeknownst to him, the Amaranth corner was taking place. Neither the FERC nor the CFTC had a clue about what was going on.

Missing a massive manipulation is embarrassing, but the real damage came when the blind ignorance of the FERC led it to waste the chance to use its newly minted powers under the Energy Policy Act of 2005 to follow our recommendations to adopt a broad view of abusive behaviors that afflict energy commodity markets.[9] As I wrote in the natural gas report:

> The FERC has also issued rules implementing the Energy Policy Act of 2005 that change its market monitoring procedures and implement new powers granted in the Act. It has entered into a vague memorandum of understanding about sharing information. The foregoing analysis demonstrates that a lot more than manipulation is at issue in the natural gas price spiral and suggests that much more needs to be done. Both the FERC and the CFTC are looking for a very narrow range of manipulative behaviors with a very narrow telescope. Unlike other physical commodities, a vast amount of trading of natural gas goes on in the over-the-counter markets that are hidden from the view and beyond the authority of these agencies. The indices that are based on this unregulated market activity have been unreliable and remain subject to doubt.
>
> In the case of regulated activities the changes at the FERC replicate the weaknesses of the CFTC approach by adopting its definitions and case law. It may be illegal to contrive to manipulate markets and there are new fines if you are caught doing so, but the FERC is going to have great difficulty proving manipulation, when prices are "moved." It is precisely for this reason that the CFTC and the exchanges subject to its jurisdiction do more than rely on narrowly defined manipulation statutes to prevent abuse.[10]

The FERC and the CFTC have failed to adopt a broad view of abuses in financial markets. They cannot see the abuse because they are not looking for it. My earlier analysis of natural gas markets identified the numerous ways that prices can be moved by actions that are well below the radar of the FERC and the CFTC.

> There are strands in this literature that identify potential and actual abusive practices. . .
>
> manipulation facilitated by large positions,
>
> lack of transparency,
>
> structural advantages enjoyed by large traders or the exercise of market power,
>
> insider trading and self-dealing,
>
> trading practices that accelerate market trends, perhaps causing them to overshoot.[11]

Instead of taking a hard look at the broad pattern of abuse, the FERC adopted a very narrow view of manipulation, taking on the existing CFTC case law and definitions. Instead of providing new and vigorous oversight over the natural gas market, we have a second cop walking the same beat with it eyes half shut.

Unfortunately, the Federal Trade Commission has started down the same useless path. The lengthy discussion of intension (scienter) in the advanced notice of proposed rulemaking points the FTC down the same dead end path that the FERC took. The FTC needs to break out of the narrow "scienter" manipulation view to

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[8] A point-by-point response to the FERC's misguided comments on the report was provided to but never acknowledged by the Commission (Letter Appendix to Cooper, The Role of Supply, Demand and Financial).

[9] Federal Energy Regulatory Commission, Order No. 670, Prohibition of Energy Market Manipulation, Docket No. RM06–3–000, January 19, 2006; Memorandum of Understanding Between The Federal Energy Regulatory Commission and the Commodity Futures Trading in Commission Regarding Information Sharing and Treatment of Proprietary Trading and Other Information, October 12, 2005.

[10] Cooper, Mark Cooper, *The Role of Supply, Demand and Financial Commodity Markets in the Natural Gas Price Spiral,* p. 93.

[11] Cooper, Mark Cooper, *The Role of Supply, Demand and Financial Commodity Markets in the Natural Gas Price Spiral,* p. 68.

identify and attack the broad range of practices and structural conditions that can and have been moving prices in the markets.[12]

The problems that have afflicted natural gas have afflicted other energy commodities.

> Natural gas markets share this pattern of abuse with other energy markets. Unilateral actions by any of a number of individuals in any of a number of circumstances provide a landscape in which upward price movements are probable. "There are regular squeezes in the Brent [oil] market . . . The whole trick is to collect more money in CFDs [contract for differences] than you lose on the physical squeeze . . . People seem to do it in turn. It depends on who's smart enough to move in a way nobody notices until it happens."
>
> In a case brought by a private party in late 2001, the practical reality was revealed.
>
> Tosco won a settlement claiming that Arcadia Petroleum (a British subsidiary of the Japanese firm Mitsui) engineered an elaborate scheme to manipulate oil prices in September 2001 through the use of OTC derivatives and a large cash market position to corner the market in Brent crude oil. As a result, the price of Brent crude soared between August 21 and September 5, and pushed its price to a premium over West Texas Intermediate crude oil (WTI) . . .
>
> *Dated Brent, which acts as a price marker for many international grades, is physical crude traded on an informal market, rather than a regulated futures exchange. This lack of regulation poses problems for oil producers and consumers seeking a fair price . . . A typical Brent squeeze involves a company quietly building a strong position in short-term swaps called contracts for difference, or CFD's, for a differential not reflected in current prices. The company then buys enough cargoes in the dated Brent market to drive the physical price higher, which boosts the CFD differential . . .*
>
> *The Company may lose money on the physical side, but it's more than compensated for by profits on its offsetting paper position in the short-term swaps market."*[13]

The problem in oil markets has continued to mount, as I explained in a law review article last year.

> On April 29, 2006, the *New York Times* ran a front-page article under the headline "Trading Frenzy Adds to Jump in Price of Oil."[14] The *Times* article opens with a brief paragraph on the conditions in the physical market but then devotes about 36 column inches to the proposition that financial markets are adding to the price increase.
>
> "A global economic boom, sharply higher demand, extraordinarily tight supplies and domestic instability in many of the world's top oil-producing countries—in that environment higher oil prices were inevitable.
>
> But crude oil is not merely a physical commodity . . . It has also become a valuable financial asset, bought and sold in electronic exchanges by traders around the world. And they, too, have helped push prices higher . . .
>
> "Gold prices do not go up because jewelers need more gold, they go up because gold is an investment," said Roger Diwan, a partner with PFC Energy, a Washington-based consultant. "The same has happened to oil . . ."
>
> "It is the case," complained BP's chief executive, Lord Browne, "that the price of oil has gone up while nothing has changed physically."[15]
>
> Three key factors serve to drive the price spiral higher: volume, volatility and risk . . .
>
> The structure and availability of markets plays a role in allowing the volumes to increase.
>
> Changes in the way oil is traded have contributed their part as well. On Nymex, oil contracts held mostly by hedge funds—essentially private investment vehicles for the wealthy and institutions, run by traders who share risk

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[12] Federal Trade Commission, *Prohibition on Market Manipulation and False Information in Subtitle B of the Energy Independence and Security Act of 2007,* 16 CFR 317.

[13] Cooper, Mark Cooper, *The Role of Supply, Demand and Financial Commodity Markets in the Natural Gas Price Spiral,* p. 64.

[14] Jad Mouawad & Heather Timmons, *Trading Frenzy Adds to Jump in Price of Oil,* N.Y. Times, Apr. 29, 2006, at A–1.

[15] *Id.*

> and reward with their partners—rose above one billion barrels this month, twice the amount held 5 years ago.
>
> Beyond that, trading has also increased outside official exchanges, including swaps or over-the-counter trades conducted directly between, say, a bank and an airline . . .
>
> Such trading is a 24-hour business. And more sophisticated electronic technology allows more money to pour into oil, quicker than ever before, from anywhere in the world.
>
> The influx of new money is sustained by movements of different institutions and individuals into the market. "Everybody is jumping into commodities and there is a log of cash chasing oil," said Philip K. Verleger Jr., a consultant and former senior advisor on energy policy at the Treasury Department."
>
> This fundamental observation had been offered a couple of years earlier in a front page *Wall Street Journal* article entitled, "Oil Brings Surge in Speculators Betting on Prices: Large Investors Playing Ongoing Rise is Increasing Demand and Price Itself:"
>
> Oil has become a speculator's paradise. Surging energy prices have attracted a horde of investors—and their feverish betting on rising prices has itself contributed to the climb.
>
> These investors have driven up volume on commodities' exchanges and prompted a large push among Wall Street banks and brokerage firms. . .to beef up energy-trading capabilities. As the action has picked up in the past year, those profiting include large, well-known hedge funds, an emerging group of high-rollers, as well as descendants of once-highflying energy-trading shops such as Enron Corp.[16]

A recent paper from the Japanese Ministry of Economy Trade and Industry (METI) has echoed the conclusion of the Senate Permanent Subcommittee on Investigations.

> According to the METI paper, during the second half of 2007, when the physical price of Wet Texas Intermediate crude averaged $US90 a barrel, market speculation, geopolitical risk and currency factors were responsible for $US30–$US40 of the price.
>
> The average WTI "fundamental price," consistent with the underlying supply/demand situation, was around $US60/barrel during the December half-year, according to the paper, citing research for the Institute of Energy Economics in Japan.
>
> Last week the benchmark WTI futures contract touched $US135/bbl, more than double the level of a year previously.
>
> "We cannot say exactly what the fundamental price is at the moment," a METI official said yesterday. "But we believe the increases this year in the market price have much to do with the influx of speculative money.[17]

The study from the Institute on Energy Economics mentioned above draws a direct link between the growth in speculation and the rising price.

> In the futures market, oil-futures trading at New York Mercantile Exchange (NYMEX) are expanding faster than actual spots. While the futures markets are designed to hedge price fluctuations risks, oil is becoming a commodity, making the futures market something like an alternative investment target. As a result, long position by speculators ("non-commercial" and "non-reportable") conspicuously leads to a rise in the oil prices in more cases.[18]

The plague of the "influx of speculative money" has now spread to food commodities. For instance, the evidence is mounting that speculation is contributing to the run up in food commodity prices that we have experienced over the past year. Speculation can be seen as contributing to price increases and volatility, as a study from the University of Wisconsin recently noted.

> One unique aspect of the market the last year has been the size of the non-commercial position in the futures market for corn. Speculative traders have significantly increased their net long position over the last year, while non-commercial traders have tended to be net short. Note that corn prices have been

[16] *Id.*

[17] Peter Alford, "Japan Blames Speculators for Oil Hike," May 28, 2008.

[18] Akira Yanagisawa, *Decomposition Analysis of the Soaring Crude Oil Prices: Analyzing the Effects of Fundamentals and Premium* (Institute of Energy Economics, March 2008), p. 5.

highly correlated with the net positions of non-commercial traders since the first quarter of 2006/2007, and the speculators have had large net long positions most of the year. It is important to note that this does not imply causality, only correlation. However, there does appear to be reason to study more carefully the impact of speculative activity on both price levels and volatility.[19]

Policy must Recognize the Unique Nature of Vital Commodities and the Dysfunctional Nature of Current Financial Markets

It would be reassuring if we could blame the current speculative bubble on the arrogance, ignorance and ineptitude of the regulatory agencies with oversight responsibilities. If that were the case, we could just fire the commissioners and secretaries and clean up the problem. Unfortunately, there is a more fundamental problem that must be addressed. Federal authorities must look broadly at the conditions in modern financial markets that feed volatility, amp up volume, and increase risk and policymakers must impose new structural oversight on these markets to return them to their proper role, as institutions that help smooth the functioning of physical markets. They have become centers of idle speculation that do vastly more harm than good.

Congress must recognize that certain commodities are fundamentally different. Energy is at the top of the list of commodities that have special vulnerabilities, but energy commodities are not alone. The transformation of commodity markets into speculative engines is hurting food commodities as well. The description I wrote of natural gas applies to greater or lesser degree to the entire energy complex and many food commodities.

> Because natural gas is a physical commodity that is actually consumed (unlike a pure financial instrument), difficult to store, and expensive to transport, natural gas markets are challenging . . . The key elements identified are the supply-side difficulties of production, transportation and storage, and the demand-side challenges of providing for a continuous flow of energy to meet inflexible demand, which is subject to seasonal consumption patterns.
>
> "[T]he deliverables in money markets consist of a "piece of paper" or its electronic equivalent, which are easily stored and transferred and are insensitive to weather conditions. Energy markets paint a more complicated picture. Energies respond to the dynamic interplay between producing and using; transferring and storing; buying and selling—and ultimately "burning" actual physical products. Issues of storage, transport, weather and technological advances play a major role here. In energy markets, the supply side concerns not only the storage and transfer of the actual commodity, but also how to get the actual commodity out of the ground. The end user truly consumes the asset. Residential users need energy for heating in the winter and cooling in the summer, and industrial users' own products continually depend on energy to keep the plants running and to avoid the high cost of stopping and restarting them. Each of these energy participants—be they producers or end users—deals with a different set of fundamental drivers, which in turn affect the behavior of energy markets . . .
>
> What makes energies so different is the excessive number of fundamental price drivers, which cause extremely complex price behavior."
>
> Complexity of physical characteristics translates into a highly vulnerable product in this commodity market.
>
> "Although the formal analysis examines transportation costs as the source of friction, the consumption distortion results suggest that any friction that makes it costly to return a commodity to its original owners (such as storage costs or search costs) may facilitate manipulation.
>
> The extent of market power depends on supply and demand conditions, seasonal factors, and transport costs. These transport cost related frictions are likely to be important in many markets, including grains, non-precious metals, and petroleum products.
>
> Transportation costs are an example of an economic friction that isolates geographically dispersed consumers. The results therefore suggest that any form

[19] T. Randall Fortenbery and Hwanil Park, *The Effect of Ethanol Production on the U.S. National Corn Price,* University of Wisconsin-Madison, Department of Agricultural Economics, Staff Paper 523, April 2008, p. 16.

of transactions cost that impedes the transfer of a commodity among consumers can make manipulation possible.[20]

These characteristics demand much more vigorous oversight of energy and food commodity markets than other commodities, especially financial instruments and precious metals that have few physical uses. Unfortunately, for about a decade we have had much less oversight of energy markets. More broadly, the transformation of commodity markets generally has created problems for physical markets. When commodity markets lose touch with the underlying physical market fundamentals, they do more harm than good.

Physical traders get frozen out. I found this in my study of the natural gas market. The utilities that actually sell the gas to the consumer could not play in the hyper-inflated commodity markets. They simply tied their purchases to the indexes, hoped for the best and let the consumer suffer the consequences.

> There is a general consensus that utilities are not in the markets as hedgers, although a small number are. Moreover, there is a belief that hedging has declined, as volatility and large financial players have moved into the market.
>
> "Most utilities have stopped hedging and instead rely on the fuel-adjustment clause that allows them to pass on to consumers . . . Many utilities exited trading, Duke being the last one. The point is they are not really in the game except for Constellation, Sempra, Dominion and a few others. That more customers are exposed to price risk because they are passing on the higher costs to customers."
>
> Cooper said many utilities probably have stopped hedging in such a risky environment because they have to eat their losses if they miscalculate. "Utilities are not in the business of predicting prices," he said. "They don't care what the price it. They pass it on to customers."
>
> While the institutional context in which utilities function certainly restricts their inclination to play in the financial market, as volatility and prices mount, it becomes more burdensome for all users. The cost of hedging becomes higher and higher.
>
> But with gas above $10/mmBtu and futures market direction unpredictable, even hedging and other risk management tools are becoming more and more expensive—raising the question of whether the benefit is worth the cost . . .
>
> For example, Invista uses financial derivatives, collars and similar tools to hedge against current market conditions. But gas at $10/mmBtu or higher and unprecedented volatility "makes all of these actions a little more costly," Poole noted. "It raises the question: is the elimination of price volatility worth the cost?"
>
> And while Invista has the money and in-house expertise to handle risk management activities internally rather than farming them out to marketers or energy service companies, "unfortunately, for smaller-volume companies that may not be a feasible option."
>
> Tying prices to indices is the ultimate short-term strategy. This institutional view raises concerns because the capital-intensive infrastructure of the industry has historically been financed by long-term contracts. The deregulation and unbundling of the industry inevitably shortened the time horizon of the participant. Flexibility and choice loosens commitments and makes "bypass" possible. Pipelines cannot count on shippers as much as in the past. Utilities cannot count on load as much as in the past. Merchants demand faster recovery of costs.
>
> In fact, a major impetus for restructuring of the natural gas industry was the high social cost associated with rigid long-term contractual arrangements . . .
>
> With the natural-gas sector restructuring . . . trading arrangements have become much more short term and flexible in both price and in terms and conditions. We have observed this phenomenon throughout the natural-gas sector, from gas procurement, gas storage, and retail transactions, to capacity contracting for pipeline services.
>
> Long-term commitments to transportation and storage facilities, exposes the contracting parties to greater risk in this environment, especially where long-term commitments to supply cannot be secured. The mismatch between the in-

[20] Cooper, Mark Cooper, *The Role of Supply, Demand and Financial Commodity Markets in the Natural Gas Price Spiral,* pp. 28–29

centive structure and the necessary time horizon results in missed opportunities. For example,

Jack Flautt, Managing Director of March & McLean, suggested there is an anomaly in the storage investment area. It is strange, in his view, that investors are not trampling one another to participate in the storage development market. "The value of storage today is greater than at any time in my lifetime," but Flautt reported he gets only blank stares from bankers at the suggestion.

The hesitance of public utility commissions to push utilities to jump back in to long-term commitments is understandable and the task of realigning risks is challenging.[21]

The disutility of hyper-inflated commodity markets was recently underscored by a study of food commodities conducted by Texas A&M University.

> The increased activity in futures markets has had the unexpected consequence of reducing producer's ability to manage price risk using futures markets. The large influx of money into the markets, typically long positions, has pushed commodities to extremely high levels. But, these funds also quickly move large amounts of money in and out of positions. This has generated much more price volatility in the futures markets. In response, the exchanges have increased the daily move limits for most of the agricultural commodities over the past 6 months. . . .
>
> The up and down volatility in the market and expanded trading price limits mean that more margin calls occur. Small elevators and even large grain companies and cotton merchants, who are trading even larger volumes, not to mention farmers doing their own price risk management, have been unable to make the margin calls.
>
> Producers, elevators, and companies use bank financing to finance their businesses and the price risk management. As the margin calls have increased, they have exhausted their ability to finance their normal hedging activities and have therefore been forced out of the market.[22]

Simply put, commercial entities that need the physical commodities to run their enterprises are priced out of the market. If you do not have deep pockets, are tied to the physical schedule of production and consumption, and live in the real world of bank finance, hyper-inflated commodity markets are a big part of the problem, not the solution.

Policy Responses

The exchanges have come to serve the interests of the idle rich speculators by constantly adjusting rules to make it comfortable for the non-commercial entities to play their games and abandoned their role of providing liquidity to promote productive commercial enterprise. We need to deflate this speculative bubble and return these commodity markets to their proper role.

Oversight

Congress has closed a loophole in the Commodity Futures Trading Commission Modernization Act that allowed energy commodities traded off exchanges to go unregulated. This foolish provision allowed the Enron debacle to spread broadly to energy markets and fostered dozens of other cases and uncounted thousands of abuses. Affectionately known as the Enron-loophole, Congress recently voted to close it, but that is not enough. Congress needs to make sure that this provision is implemented with extreme vigor. Large traders who trade in commodities in the U.S. ought to be required to register and report their entire positions in those commodities here in the U.S. and abroad. Registration and reporting should trigger scrutiny to ensure the good character, integrity and competence of traders.

If traders are not subject to comprehensive reporting requirements, there will always be room for mischief that is out of sight to the regulator. If they are unwilling to report all their positions, they should not be allowed to trade in U.S. markets. If they violate this provision, they should go to jail. Fines are not enough to dissuade abuse in these commodity markets because there is just too much money to be made. We need mandatory jail sentences.

Regulatory authorities must also require full auditing of private indexes. The FERC failed to impose this condition on the critical natural gas indexes and has

[21] Cooper, Mark Cooper, *The Role of Supply, Demand and Financial Commodity Markets in the Natural Gas Price Spiral,* pp. 28–29

[22] David P Anderson, *et al. The Effects of Ethanol on Texas Food and Feed, Agricultural and Food Policy Center,* Texas A&M University, April 10, 2008, p. 32.

been tied up in court over even modest transparency requirements. Federal and state regulators should refuse to allow indices that are not fully audited and transparent to be used in any ratemaking transactions. Unaudited indices should simply not be allowed to influence consumer costs in regulatory proceedings.

Incentives

We need to restore the balance between speculation and productive investment. Public policy has made speculation much more attractive that investment in genuinely productive enterprise. Not only was energy commodity trading less regulated, it was also less demanding. Margin requirements on organized exchanges are a fraction of the margin requirements on stocks. If it is cheaper to put your money into speculation, why bother with real investment. The margin requirement for commodity trading among non-commercial traders should be fifty percent higher than the margin requirement for investment in stocks. However, we should impose less onerous terms on physical players and even scale the terms to the size of the position, so that smaller physical players can regain access to these futures markets.

We must also set lower position limits and increase settlement windows so that individual players cannot influence price.

We must level the playing field between long-term productive investment and short-term speculative gains. We need a tax on short-term capital gains between 33 and 50 percent, (which reflects the difference in the net present value of income from on a one-year investment repeatedly flipped and the net present value of a stream of income an investment held for 10 years—discounted at the OMB suggested discount rates of 7 and 10 percent respectively), to make holding productive investments for long periods as attractive as flipping short-term financial paper.

Physical Markets

While this hearing focuses on the financial markets, I would be remiss if I did not also mention the physical market. Again, my analysis of natural gas markets provides a broad framework for oversight policies to begin addressing the institutional flaws that have given rise to physical market problems.

> In the physical market, policymakers have allowed the supply side to become concentrated and vulnerable to the exercise of market power. Meanwhile, producers have been slow to invest in exploration and development, compounding the problem of tight supplies.
>
> The Federal Energy Regulatory Commission exacerbated the problem by failing to ensure a transparent price reporting mechanism. It deregulated markets and granted market-based rate authority without requiring full and honest disclosure of information or effective competition on the ground. In retrospect, it appears that there have been repeated market "aberrations," but fraud and market manipulation are not the only concerns. The ability of strategic behavior to influence price because of structural weaknesses in market rules is a more general concern.
>
> The position of the major oil companies with large holdings of natural gas physical assets, dominance of natural gas marketing, and active involvement in natural gas financial markets poses a serious threat to consumers. The inadequate investment in exploration over the course of a decade or more contributed to the tight supply conditions. The massive windfall of cash-flow in recent years dulls the incentive for the majors to supply gas to the market. They can keep it in the ground and hold out for higher prices. They are under no pressure to sign long-term contracts, except at extremely high prices. As major marketers and traders, they can move markets.
>
> The fact that the majors straddle these markets, several of which are lightly or unregulated, compounds the problem, since their ability to profit by taking contrary positions in various markets is hidden from regulators. Policymakers must have the information necessary to make informed judgments about whether the major oil companies are exercising market power, strategically in the long-term and unfairly exploiting the tight markets they have helped to create in the short term.
>
> A joint task force of Federal and state anti-trust and regulatory authorities should be formed . . .

Conclusion

Vigorously enforced registering and reporting requirements will chase the bad actors out of the commodity markets and the margin and tax policies will direct capital out of speculation and into productive long-term uses. Creating a class of idle rich speculators, who are immune to the business cycle, was a huge mistake. Allow-

ing this huge log of money to pump up the volume, volatility and risk has cost consumers dearly.

Let us assume a modest estimate of $30 per barrel that is cited by industry analysts as the amount that the speculative bubble has added to the price of oil in the past 2 years and use my modest estimate of $2.50 per thousand cubic feet for natural gas. Since the Senate Committee on Oversight and Investigations issued its report, the speculative bubble in energy commodities has cost America well over half a trillion dollars. It is time to do something about it.

The investigations of manipulation by the FERC and the CFTC, stepped up grudgingly in response to mounting political pressure, are woefully inadequate and looking for the wrong thing. This is not a question of manipulation, but a fundamental breakdown of the functioning of these markets. The FTC seems inclined to make the same mistake in its Advanced Notice of Proposed Rulemaking. We need much more vigorous action to reign in the speculative bubble and return the futures markets to their proper role to improve the functioning of physical commodity markets.

Senator CANTWELL. Thank you very much.

And I, again, want to thank all the witnesses for testifying today and for your testimony, that can be submitted in full to the record.

You know, I heard from many of you commenting about commodity indexes and the process by which the futures market operates, and I just want to make sure that I'm clear. If I could just ask each of you if you believe that the current price for oil is based only on supply-and-demand fundamentals or if it's based on other things, as well. If you could just give me a yes or no. Because I think I understand where each of you are, but I want to try to be a little more succinct about whether this is—the current price is based on supply-and-demand only, or are we seeing other factors?

Mr. GREENBERGER. Well, I'll take the first crack at that. I think the price is completely unmoored from supply demand. I don't want to discount supply demand; there is a supply demand problem. But, I think the vice president of ExxonMobil, who said that his judgment was that the price should be at $50 or $55, another oil executive said somewhere between $35 and $65—the price of oil at the beginning of this millennium was $18 a barrel. Yes, it should be higher than it is, and we need to do all the efforts, more substitute energy, et cetera. But, we're paying, some believe, as high as 50 percent premium to the pockets of speculators who are operating in markets that are completely unpoliced. It's the equivalent of telling a community, "The crime rate has been low. We're pulling the police back. They're too expensive. Be sure you lock your doors."

Senator CANTWELL. I should have said, at the beginning, that I am going to do 5-minute rounds here, so—to try to keep us—a flow of members asking questions—so, if you could be succinct—so, I was just looking for, kind of, a yes or no on whether people thought it was——

Mr. GREENBERGER. Sorry.

Senator CANTWELL.—the current price was only based on supply and demand, or other things were impacting it.

Mr. Soros?

Mr. SOROS. There is definitely a speculative bubble that is superimposed on fundamental trends in supply and demand. That is not specific to the present moment, because this is in the nature of markets. Markets don't just passively reflect fundamentals. What speculation, or prevailing biases or misconceptions prevail in the market also affect the so-called fundamentals that markets are

supposed to reflect. And occasionally they go into this self-reinforcing bubble mode, and I think this is what we are witnessing today in the oil market. But, we have seen it in housing—we see it all the time.

Senator CANTWELL. Mr. Ramm, do you have a quick answer to that? Dr. Cooper, do either of you have a quick answer to that?

Mr. RAMM. The quick answer is no.

Senator CANTWELL. It's not just supply and demand.

Mr. RAMM. It isn't.

Senator CANTWELL. Yes.

Mr. RAMM. With respect to the fact that if you only look at the physical supply and demand, it would not base—get based on those fundamentals.

Senator CANTWELL. Dr. Cooper?

Dr. COOPER. I'll be quite precise. Forty dollars for the physical cost of producing crude, the economic cost; $40 for the cartel tax that OPEC and the oil companies put on us; and $40 for speculation. So that two-thirds of the current price is, simply put, baloney.

Senator CANTWELL. OK.

Ms. Watson, I know you're probably going to tell me you can't answer, so I'm not even going to ask you about that.

So, Dr.—Mr. Soros, you, in your testimony, said that circumventing speculative position limits should be banned, provided that that ban can be applied to, you know, all markets.

Mr. SOROS. Yes.

Senator CANTWELL. You're basically saying that the speculation position, the lack thereof, is causing a great deal of what we're seeing—or could cause a great deal of what we're seeing in this bubble.

Mr. SOROS. Whenever you have outside speculators coming into a market on a very large scale, and particularly coming in on one side of that market, in present time on the buying side, they do distort the otherwise prevailing balance between supply and demand. So, the presence of financial speculation can—have some useful service in providing liquidity, but when it gets too big, it can unbalance the market, and that is why there should be limits on speculative positions, and those limits should bear some relationship to the size of the market that you are dealing with.

The oil market is very big, but some of the agricultural markets are very small, and speculation can really play havoc.

Senator CANTWELL. Mr. Greenberger, do we have speculation limits on all U.S. oil-traded product?

Mr. GREENBERGER. Absolutely not. We have them on some, but large portions not, because in 2000 this Congress said, "You can trade outside of regulated exchanges." And, because of that Enron loophole, which I believe has not been closed for crude oil, there are no—no speculation limits in these markets that are unregulated. There's a second charade that an exchange located in Atlanta trading U.S.-delivered products is really in the United Kingdom, or Dubai, who's partnered with New York Mercantile——

Senator CANTWELL. But that is a U.S. commodity?

Mr. GREENBERGER. Absolutely. They're trading U.S. West Texas Intermediate; 30 percent of the market is in a—is in an exchange that has no spec limits.

And, by the way—Mr. Soros talks about index speculation—we just discovered, in the last 2 weeks, that even our regulated markets are treating those banks and hedge funds that are in index positions as commercial interests not subject to speculation. My calculation is, right now, that at least 70 percent of the U.S. crude-oil market is driven by speculators and not people with commercial interests. Most of those speculators do not have spec limits; they can buy whatever they want.

Senator CANTWELL. Thank you.

Senator Dorgan?

Senator DORGAN. Thank you very much.

I just want to observe that the Commodity futures Trading Commission has seen an 8 percent decrease in its staff over time, and an 8,000-percent increase in commodity trading. Let me say that again, because some people think, in this Congress, and have for some while, that regulation is a four-letter word. This important regulatory body has seen an 8,000 percent increase in commodity trading and, at the same time, a 12 percent decrease in their staffing level. That speaks volumes, in my judgment.

Now, let me ask—Mr. Greenberger, tell me succinctly—you told us what's wrong, and suggested that, you know, the officialdom here is a dope, in terms of thinking they had closed the loophole. What steps would you take to address these issues?

Mr. GREENBERGER. I have it in my testimony. I would go back to the status quo ante before the Enron loophole was passed. The status quo ante was, if you're trading energy futures in the United States, they must be traded on a regulated exchange that has speculation limits, margin requirements, et cetera.

The Enron loophole told energy traders, "Go—you can go wherever you want, there's no margin requirements and no regulated margin requirements, no spec limits, no large traders reporting." You—I've proposed adding two words to the Commodity Exchange Act: the words "energy" in two different places, and everybody who trades energy would, as Mr. Soros said, have speculation limits if they're speculators.

Senator DORGAN. Yes. I think you alluded to it, but you know and I know that was not a deliberate policy—the creation of that loophole was not a deliberate policy debated by the Congress, it was, in my judgment, a shameful chapter of something being stuck in, in the midnight hours, in a large piece of legislation that was moving, and it has caused massive amounts of problems, and continues to cause significant problems.

Mr. GREENBERGER. Absolutely. And, by the way, I should just add, Alan Greenspan advised against it.

Senator DORGAN. Yes. Even a stopped clock is right twice a day, they say.

[Laughter.]

Senator DORGAN. Mr. Greenspan—and let me just——

[Laughter.]

Senator DORGAN. Let me also make the point that, while a lot of this speculation—and I mentioned subprime earlier—has been going on—a lot of folks, including Mr. Greenspan at this—at the Fed—sat at their chair without taking the kind of action that should have been taken.

But, let me go to another point, if I might. I want to ask you about margin requirements. NYMEX and others will say, you know, "We don't have evidence of unbelievable speculation. If it exists, it must be over on the dark side, it must be on the unregulated side." They say, "Increasing margin requirements will do nothing." Respond to that, if you will, Mr. Greenberger.

Mr. GREENBERGER. Oh, well, look, NYMEX says that because they treat investment banks and hedge funds as oil dealers. They're——

Senator DORGAN. And they are not.

Mr. GREENBERGER. Yes. Of course they're not. Thirty percent of what they deem to be oil dealers are Morgan——

Senator DORGAN. I understand.

Mr. GREENBERGER.—Stanley and Goldman Sachs. So, they say, "Wow. You know, we look at the speculators and they don't include one-half the speculators." Yes, if you impose margin requirements, it's an unfortunate thing that we have to talk about this, but speculators should have increased margin requirements.

Senator DORGAN. You think it will be effective.

Mr. GREENBERGER. It—as Mr. Soros said, it's a last resort, but we're desperate right now.

Senator DORGAN. Mr. Soros, what should the increase in margin requirements be? I believe the margin requirement on stocks is about 50 percent. I think, on these contracts, it's 5 to 7 percent. What do you suggest we do with——

Mr. SOROS. Unfortunately——

Senator DORGAN.—respect to margin——

Mr. SOROS.—I'm really not an expert in the oil markets. I said that in my testimony. And so, I really can't express a view. I'm just not familiar enough with oil trading to be able to say.

Senator DORGAN. Dr. Cooper, what do you recommend?

Dr. COOPER. I want to make an observation. I did a report for attorneys general in four Midwestern states—Illinois, Iowa, Missouri, and Wisconsin. We looked at the natural gas market, and much of my testimony reflects our early—this was in March of——

Senator DORGAN. Right.

Dr. COOPER.—2006, a couple of months before the Permanent Committee came out with a similar finding. The fascinating thing was that, at the time, a puny hedge fund—and, let's be clear, Amaranth was not a very big hedge fund—a puny hedge fund had accumulated a massive position in the natural gas market, and the CFTC and the FERC did not have a clue. They were completely in the dark about this going on.

Now, as we've heard, a year and a half later the FERC sort of starts to figure it out and fines these folks a little bit of money. And compared to these markets, it's a little bit of money.

The simple fact of the matter is that you cannot let these people play. Enron loved its title. They called themselves "asset light." And everyone thought that was the neatest thing in the world, because, hey, if you don't have any——

Senator DORGAN. Right.

Dr. COOPER.—assets, you can really fool around. The simple fact of the matter is that if we tie trading to real assets, we will dis-

cipline the heck out of people who are running around in these markets.

Senator DORGAN. Just one more quick point. Investment banks and others are taking large positions on this commodity where they have not previously taken positions. Then we hear Goldman Sachs say, "We think it's going to be—it's going to go to $200 a barrel." Is there an impression, of anybody on the table, that if you look behind the curtain you'd see people taking long positions on oil and then making statements? Would that be surprising?

Mr. GREENBERGER. Oh, Goldman Sachs is very, very long in these markets. As Mr. Soros said, these banks have gotten into the—these financial institutions have dominated this—markets, and they're on the long side. That's why the price is going up, and that's why commercial users who need these markets can't use them, because the price of these contracts are going through the roof.

Senator DORGAN. Is it in their interest to predict higher prices?

Mr. GREENBERGER. Well, I don't want to—let me just say, from my observation, I find it highly ironic that when you control the price of crude oil, that you can comfortably predict it will go up from $135 to $200. I find that to be more than a mere coincidence.

Senator DORGAN. I have another round of questions, but my time is expired.

Senator CANTWELL. Thank you.

Senator Snowe? Or, Senator Klobuchar?

Senator KLOBUCHAR. Thank you very much, Madam Chair.

Mr. Greenberger, as I was listening to you rail, understandably, on the Enron loophole and how it's not really closed when it comes to crude oil, I was reminded of a forum that we had just a few days ago in Moorhead, Minnesota, where someone, who had just your tone of voice—he was just a retired guy that was standing there and saying, "Congress keeps saying they're doing stuff, but they're not really doing stuff." So, what I want to get at right now is how we can really get something done here.

And you talked, and Senator Dorgan just asked you a few questions, about the Enron loophole, so I—from my understanding of this in your testimony is that the first problem with it—put aside the crude oil—was that the way the language read in the farm bill, you saw that it just put too much burden on the CFTC to try to get to the bottom of it. And tell me about that and what the problem is with that and how that can be fixed.

Mr. GREENBERGER. Before the Enron loophole passed, for 78 years, the status quo had been, "If you trade a futures contract, it must be regulated. If you want to get it deregulated, the trader has the burden to demonstrate that deregulation will not lead to fraud, manipulation, and excessive speculation." The Enron loophole said to all the speculators, "Go wherever you want. You have no controls." The "End the Enron Loophole" says, "On a contract-by-contract basis, it is now the burden of the CFTC to prove that each contract should be regulated." So, it has to go through complicated administrative hearings, which I can tell you will be challenged vigorously by people who can afford to make those challenges, and will have to prove, by substantial evidence, that that contract will be regulated. Those decisions will be challenged judicially, that—

it's a nightmare, and the CFTC said it knows of one contract, over the thousands in this area, that it believes should be brought out from the shadows of the Enron loophole.

Senator KLOBUCHAR. OK. Then the second thing—so, it's to change that language with the burden, but the second thing is, while the language covered crude oil, because of the CFTC's actions with these "no action" letters that Mr. Ramm was talking about, that that is also an additional problem. And I think this bill was introduced, which is Senate file 2995, that attempts to fix that, but you don't believe that it would fix it.

Mr. GREENBERGER. I have——

Senator KLOBUCHAR. And you want to elaborate on that?

Mr. GREENBERGER. I have a lengthy dissertation on that. There is now nothing in the law that sanctions foreign board of trades in the United States trading U.S. products being able to escape regulation. That legislation says, "If the CFTC finds the home regulator comparable, it's OK for them not to be regulated." The CFTC, in May 2007, found the Dubai Financial Services Authority to have, quote, "comparable regulation to the United States." So, that legislation will sanction——

Senator KLOBUCHAR. What they did.

Mr. GREENBERGER.—what is now, in my belief, illegal, and will soon, if somebody wakes up, be invalidated either by a private individual being hurt by it, or a State attorney general. If you pass that, you'll block attorney generals from getting rid of that loophole.

Senator KLOBUCHAR. So, your argument is, which you just—you gave your idea to Senator Dorgan—that the idea is to put the words "energy" back in so that we can actually go back to where we were before this—what Dr. Cooper calls "the foolish, but affectionately called, Enron loophole" got put into the law?

Mr. GREENBERGER. Yes. Overnight, that will bring down the price of crude oil, I believe, by 25 percent. Now, there has to be a grace period, obviously, but it would say that anybody in the United States trading United States-delivered products must be subject to regulation.

Senator KLOBUCHAR. Mr. Ramm, is your idea consistent with what Mr. Greenberger has been saying? By the way, I think it's interesting for people to know, who are watching this, that a lot of people think gas stations have been making money, hand over foot, during these increased prices, and I think it's interesting to hear you talk about the fact that we need more regulation of speculation, because, in fact, it's not true.

Mr. Ramm?

Mr. RAMM. We are completely in agreement with rescinding the "no action" letters, because of the things that have happened to date. And, you're right, petroleum marketers are going out of business, farmers are going out of business. We can't get the capital to finance our receivables. Farmers can't get the capital to get the money to operate their farms.

Now, I know that the CFTC has put out an announcement in trying to help with the Banking Committee to try to free up capital for farmers, but oil marketers won't be able to deliver that fuel, be-

cause they can't afford to buy it, to have receivables for it either. So, we'd be looking for some relief there also.

Senator KLOBUCHAR. OK. I just wanted to thank both of you, because I can tell you, I'm not going up and telling that guy yelling at the forum in Moorhead that Dubai is going to take care of him. So, thank you for your thoughts and ideas, and I'm sure we'll be using them as we go forward.

Senator CANTWELL. Senator Snowe?

STATEMENT OF HON. OLYMPIA J. SNOWE, U.S. SENATOR FROM MAINE

Senator SNOWE. Thank you, Madam Chair. And I thank you for holding this hearing today on this very critical issue, and examining one of the—you know, most unexamined, unexplored areas, which is the energy futures market, that's certainly deeply disturbing and deeply troubling, certainly puts us at a tipping point in our economy with respect to the high energy prices. And I know, for my constituents in Maine, the questions that they are asking is exactly why this is happening, it's totally inexplicable, in terms of where we are today.

As you said, Mr. Ramm, about home heating oil prices in my state, 80 percent of winter heat's derived from oil. Eighty percent. And the price currently is $4.50. You know, it went up a single day in May, according to my Maine oil dealers, 30 cents in one day, 7 percent. It just doesn't—you know, it just doesn't stand to reason, it's not rational. And I'm concerned because clearly it represents a tipping point for America, in terms of its economy and for Americans. You know, we're talking about maybe, you know, $5,000 oil bills for the average Mainer or anybody using home heating oil next winter. And, I mean, that's now. We're not—we have no way of knowing what it's going to be next winter. You pay a cap price of $4.89 in Maine right now.

So, this is deeply disturbing and devastating. I mean, it could place our economy in ruins. People are asking the question, why is this happening? And it is not based on supply and demand, and that's what I'm hearing. Would you all agree it is not—and that's the question that Madam Chair asked, and whether or not it's based on supply and demand. And it's not.

And so, we've taken the first step in the farm bill. Senator Feinstein and I and Senator Cantwell introduced—that legislation became law several weeks ago. But, I'm concerned about the timidity of the agencies, as well, in not aggressively pursuing the speculation that's now pervasive.

So, one of the questions I would like to ask is, with respect to the foreign board of trades, should we have the ability to limit their positions? You know, in fact, in one of our questions that we posed to the Commodity Futures Trading Commission recently in a letter that Senator Feinstein, Senator Cantwell and I submitted with respect to the West Texas Intermediate crude oil futures that now represent—31 percent of U.S. oil is traded on foreign markets. And this is in accordance with the response by the Commodity Futures Trading Commission. That's alarming. I mean, that is 31 percent. And so, we don't require the same standard for, obviously, foreign trades by, you know, future—by American oil speculators on for-

eign markets. Is that an area that we should be engaged in, and should we give the authority to the Commodity Futures Trading Commission to engage in that process?

Mr. Greenberger?

Mr. GREENBERGER. Senator Snowe, that is a staff—that foreign board of trade license to come into the United States and sell in the United States U.S.-delivered products but be regulated back home is a staff "no action" letter. Unfortunately, I'm embarrassed to say I wrote the template for it. It has 1,000 conditions in it. Under the present circumstances, it can and should be terminated this afternoon. It is—my view is, the way they have converted this limited license into a total exemption is grossly unlawful and makes no sense, and my view is, as Mr. Ramm said, it should be— if the CFTC doesn't come to its senses, which it could do—it's not a commission regulation, it's a letter; they could revoke it by the terms of the letter—then you must stop this, you must stop Dubai and NYMEX partnering, selling commodities in the United States on the assumption that speculation will be controlled in Dubai.

Senator SNOWE. So, is that the—is that something that we should be demanding immediately today——

Mr. GREENBERGER. As I——

Senator SNOWE.—and that they could do it unilaterally?

Mr. GREENBERGER. Oh, yes. And, as I read your letter, Senator Snowe, that's exactly what you asked. I have—I know that there are commissioners who would like to do it, but they don't have a control there. That can be ended. If they don't end it, you should end it right away.

And by the way—I know you have limited time, I hope I can just expand—what the traders come in and say is, "Oh, if you regulate us in the United States, we're going to go to Dubai and London." You know, that's phony baloney. I sat there, 10 years ago, when 18 foreign exchanges came to me and said, "We cannot survive unless we are in the United States. We need the United States investors and United States markets." They can't escape United States jurisdiction.

And I must say, if that's the reaction of Goldman Sachs and Morgan Stanley and British Petroleum to the suffering that you're experiencing, they're not going to go to London, they're going to try and trade in the United States and make it appear they're in London. But, my view is, if they want to go to Dubai, God bless. The price of gas in the United States will come dropping down. We should wish them well.

Senator SNOWE. Well, I appreciate that forthrightness. And I think that is certainly something that we should be pursuing as soon as possible. Thank you.

Thank you, Madam Chair.

Senator CANTWELL. Thank you.

Senator Pryor?

STATEMENT OF HON. MARK PRYOR,
U.S. SENATOR FROM ARKANSAS

Senator PRYOR. Thank you, Madam Chair. I appreciate you having this hearing.

Let me follow up, if I can, Mr. Greenberger, on what you were just talking about with Dubai and these other exchanges.

As I understand it, the way it works is, in order to trade in oil commodities, you only have to put 6 percent of the capital down, and that is, what, a 16-to-1 ratio, something like that. Should we look at that? Is that a way to address this?

Mr. GREENBERGER. It is "a" way, and I think it should be looked at for speculators. But, I think what Mr. Soros said is the historic, traditional answer in these markets. You need speculation to make them liquid, but you can't have 90 percent of the market be speculation, which I believe is the case today in West Texas Intermediate. The historic way, from 1922, with the Grain Act, passed by farmers—at the request of farmers, since 2000, when Mr. Gramm deregulated these markets, speculation limits were designed, contract by contract, to say, "Yes, speculators, come in, but you can only have a small part of this market. It's for Mr. Ramm. This market is for him to hedge his interests." And what we have now, I believe data will soon be released that, if you calculate, properly, the West Texas Intermediate market, you will see 90 percent of it is dominated by hedge funds, banks, endowments, pension funds, mutual funds, et cetera. They've taken over. And, as Mr. Soros said, you can't run the market like that. It's completely dysfunctional.

So, I say everybody should be regulated, spec limits should be applied, and margin increase for speculators should definitely be looked at.

Senator PRYOR. The price of West Texas crude today is, what, roughly $130 a barrel?

Mr. GREENBERGER. Well, interestingly enough, it touched $135 the day the CFTC announced that it would do something about it. By the end of the day, it was $126. So, it's somewhere between $125 and $130 right now.

Senator PRYOR. If we did the fixes that you're recommending, what do you think the price of a barrel of West Texas crude may go to?

Mr. GREENBERGER. Well, I wish I could forthrightly predict that, because I wouldn't be here now, I'd be in a beach in Rio de Janeiro.

[Laughter.]

Mr. GREENBERGER. But, my prediction is—for whatever it's worth, is you'd get at least a 25 percent drop in the cost of oil, and a corresponding drop in the cost of gasoline.

Senator PRYOR. All right, and——

Mr. GREENBERGER. Some people estimate 50 percent.

Senator PRYOR. Let me follow up on something that I know that Senator Dorgan feels very passionate about, and that is to stop putting oil into the strategic petroleum reserve, which we did, 2 or 3 weeks ago, and the President ultimately signed it. What impact will that have?

Mr. GREENBERGER. Well, you know, OPEC, which is the biggest strategic petroleum reserve in the world, will not release oil into this market, because they believe that they can throw all the oil they want to throw at this market, but the speculators will continue to drive it up. My view is, if you don't control speculation, you can empty the strategic petroleum reserve and the price of oil will

continue to go up. And that's why people say, "Oh, we want green energy, we want biofuel." Well, the biofuel developers are going to need to hedge when they get their biofuel going, and what's going to happen when you get all this new, clean energy is, the banks are going to go into those markets and rob those guys blind, like they're robbing the gas-station owners and heating-oil dealers in this country right now. Small business people are tanking. The other day, I talked to Sean Cota, who's the head of the New England Fuel Institute, and I said, "Sean, make sure you have someone at this hearing," and he wrote back and said, "Michael, I'm in a meeting with Vermont oil dealers. Half of them think they will be gone as a financial institution by the end of this week."

Senator PRYOR. If I——

Mr. SOROS. If I may——

Senator PRYOR. Yes, Mr. Soros.

Mr. SOROS. If I may point out that the additions to the index futures buying in the last few years has been a multiple of the additions to the strategic reserves, and that is the—what I call the elephant in the room.

Senator PRYOR. Explain that, if you can, to the Committee.

Mr. SOROS. Well, that these institutions, acting as a herd——

Senator PRYOR. Right.

Mr. SOROS.—are accumulating much larger—or setting aside much larger reserves than the strategic reserve is.

Senator PRYOR. Right.

Mr. SOROS. Now, of course, it's not a physical reserve, and some people argue that, therefore, it doesn't affect the price, but I would differ, because I think it does affect the price. It has the same effect as other buying.

Senator PRYOR. OK.

Dr. Cooper, let me ask you—it's a follow up to something you said earlier. You gave, kind of, a 40–40–40 to a price, I guess, of a barrel of oil. As I understand it, what you're saying is that, in your view, what, only about $40 is the real cost of a barrel of oil?

Dr. COOPER. Yes, I'd pick the middle of the range that the oil industry is—has offered, up on the Hill here in the last few months. I mean, one set of executives said $50 or $55. Now, that's at the margin. Another executive recently said $35 to $60. So, the economic cost of producing and delivering a gallon of gasoline into my car is about $2.25, if you look at the real economic costs. And everything above that is funny-money, a combination of speculation and the exercise of market power. 40–40–40 is, I think, a good representation of $120. The Institute for Energy, in Japan, recently looked at the year-end 2007 and came up with the figure of $30 or $40 for speculation. The Senate committee came up with $25, but——

Senator PRYOR. Right.

Dr. COOPER.—that was a couple of years ago.

Senator PRYOR. I understand.

All right. Well, let me ask one last question. I'm not sure who this should be directed to, but maybe all of you can chime in if you feel like you should.

There have been some reports that owners of crude-oil storage tanks and pipelines are using their knowledge regarding their in-

ventories and the flow to make bets on the future. I don't know if you're aware of these reports. Supposedly, these owners are putting out misleading information in order to make trades and to profit on that misunderstanding. Again, I don't know if you're familiar with those. But, first, do you believe that some of that is going on right now? Second, these, seem to be manipulative and deceptive acts, and what should we do to make sure this doesn't happen in the future? Well, it certainly shouldn't happen right now, but what can we do to stop it? So, who wants to take a bite at that?

Dr. COOPER. If you look at the report we—I did for the Midwest attorneys general—this was during the natural gas problem in 2006—the traders knew what was going on. I mean, they would look at the market, say, "This is wacky," and they would identify—they knew there were people who were engaging in a variety of behaviors, which the CFTC and the FERC do not think is illegal—are illegal. Under the case law, it's really tough. But, the simple fact of the matter is that there is a whole range of trading practices, including—that's insider trading; I mentioned that in my list—which, in fact, pump up the price. They are not currently on the radar screen of these agencies.

The best way to begin to address that is, one, expand the authority of the agencies, as you've done for the FTC. But, if you look at the FTC's Advance Notice of Proposed Rulemaking, they're getting ready to go down the same dead-end street that the FERC went. They're not really going to expand their power, they're just going to adopt the existing case law. But, the existing case law is inadequate to deal with the post-Enron problem in these markets.

So, you need to expand those authorities, but you also need to find ways to tie these financial markets back to the physical commodities. We don't need to trade a barrel of oil or a methane molecule 30 times between wellhead and burner tip. That's excessive liquidity. That's too much liquidity. These markets are supposed to help us get physical commodities out of the ground and into our gasoline tanks. They're not there for people to make huge fortunes. Tie the trading back to the physical reality and you will dampen down the speculation.

Senator CANTWELL. Thank you.

Senator Carper will be next, and then I know there are several members who have joined us who want to get in their first round of questions. I do intend to get a second round in, and hopefully still have us out of here roughly around noon. So, if members want to stay for a second round, that would be great.

So, Senator Carper?

STATEMENT OF HON. THOMAS R. CARPER, U.S. SENATOR FROM DELAWARE

Senator CARPER. Thank you, Madam Chair.

Welcome. It's—you're good to come. We appreciate your presence, and we appreciate your testimony.

About 2 weeks ago, we held a hearing in the Senate Banking Committee on a subject not dissimilar to the one that we're discussing here today. During the course of that discussion and testimony, the Members of the Committee, learned that there are three principal factors contributing to the run-up in oil prices. One of

those is deemed to be the change in the value of the dollar, the drop in the value of the dollar relative to many other currencies in the world. A second factor was believed to be explained by supply and demand. The third factor was speculation. I don't know that I would say one factor is greater than the other. But, is—I've joined this Committee, sort of, in midcourse here during the Q&A—is that pretty much the—where you all are coming from, as well? Are those—is that a fair summary of your conclusions, too?

[The prepared statement of Senator Carper follows:]

PREPARED STATEMENT OF HON. THOMAS R. CARPER, U.S. SENATOR FROM DELAWARE

As we have watched oil prices break record after record, many of us have expressed concern about the impact of speculators on the price of oil.

Just a few weeks ago, I asked Chairman Inouye to consider holding a hearing on this issue and here we are. I'd like to thank him for responding to my, and many of my colleague's, request so quickly.

High gas prices are impacting Americans in many ways. Transportation is becoming a larger and larger portion of the household budget. And transportation costs are impacting the cost of everything from groceries to construction.

There are many factors that go into the cost of gasoline. There is the cost of exploration of a finite and possibly dwindling resource. There is the cost of refining crude oil.

There is increasing demand from developing nations, like China and India. There has also been for increasing demand here in the U.S., as vehicle miles traveled has increased 150 percent since the 1970s.

But there is also the impact of market manipulation and speculation. We have seen speculators drive the Internet bubble and the housing bubble. And now speculators may be driving the cost of gas higher. But this speculation impacts every single American, hitting working class Americans the hardest.

Today, we will hopefully learn what we can and should do to reduce the impact of speculation on the price of oil and make sure that the price is based on supply and demand. At the least, we need to make sure there is sufficient transparency in our markets and in the participants.

If we act soon, this could help all Americans deal by lowering gas prices in the short run and prevent similar, unnecessary price spikes in the future.

However, we have a larger challenge. Even if true market forces are at work, many Americans do not have the ability to opt out of the gas market.

In many areas, if the price of something goes to high, people stop buying it. Then the market reacts and prices come down.

But because of the way most communities have been developed and the limited transportation network we have provided, most Americans have no choice but to buy gasoline.

Let's restore fair market forces to the price of gas. Let's ensure we understand who is investing in gasoline and why.

But as we discuss climate change and the reauthorization of the transportation bill next year, we must provide Americans with transportation options so that they can save money on gas, reduce demand and maybe reduce prices too.

And let's just start with Mr. Soros.

Mr. SOROS. Well, it definitely—I spoke about the backward-sloping supply curve; that is to say that oil-producing countries find it and have no incentive, or less incentive to convert their oil reserves underground, which are set to appreciate in value, into dollar reserves above ground, which have a tendency to lose their value. So, that is a very important factor in creating the current upward pressure on oil prices. Generally, the institutional demand for these commodity futures indexes is also a flight from currency. The dollar has lost its position as the unquestioned, undoubted storer of value reserve currency, and there is no suitable alternative to it. Therefore, there is a general flight from currencies and a search for

commodities. And so, the commodity—this is a very important element in the commodities movement that you're currently——

Senator CARPER. Thank you, Mr. Soros.

Mr. Greenberger?

Mr. GREENBERGER. I agree with what Mr. Soros said, and I agree with what—the assessment you articulated. And I happen to believe that there's a correlation between the weak dollar and excessive speculation. The day that the CFTC said it might do something about this, the—it was announced that oil went down $4.41. But, that was looking from the prior day's price. It went down about $7 that day. The dollar went up. The dollar went up.

If we could get our oil prices under control, it would—and our farm prices and our—by the way, the subprime meltdown all leads back to this deregulation. The critical instrument of credit default swaps freed by this act would have been regulated but for this act. If we could get these things under control, I believe the dollar would strengthen. And so, there's a correlation between speculation killing the economy and that reflecting itself in the U.S. dollar not being what it should be.

Senator CARPER. Thank you.

Mr. Ramm?

Mr. RAMM. I do agree that those are three major components of price today. In the area of supply and demand, it's kind of ironic that probably the largest cost increase in bringing supply to the market is petroleum—is the cost of petroleum, because it's forcing prices to go up on every service rig, every exploration job, and it's causing prices to go up, so it's making the cost of oil go up, by itself.

In regards to the currency, another ironic thing is that as the dollar has fallen—and it has, because of oil being traded as a U.S. currency, globally—it has taken a hit on—especially for the U.S. citizens. But, as Mr. Solos said, as that money has left those traditional markets, it has flowed into the commodity market. And he has also said that it's the elephant in the room; that amount of money, compared to the futures market, is huge. It's absolutely huge. Not as big, when you would go back to the currency market.

And then, the last would be speculation, because that, in itself, is one of the feeders of the commodity that they need, which is cash, for excess speculation.

Senator CARPER. Right.

Ms. Watson—my time's just about to expire—and Dr. Cooper—just briefly, if you would, please.

Ms. WATSON. I really can't address that on behalf of FERC, since it's not under our jurisdiction.

Senator CARPER. All right, thank you.

Dr. COOPER. 40–40–40. Forty dollars for the economic cost of——

Senator CARPER. You're good at sticking on my——

Dr. COOPER. Well, you know, but——

Senator CARPER.—staying on——

Dr. COOPER.—it's——

Senator CARPER. We can learn from you.

[Laughter.]

Dr. COOPER. The evidence clearly supports those three numbers. OPEC is only defending $80 a barrel, so the most recent $40 is

coming from someplace else. The Senate Commerce Committee, the Senate Oversight Investigations Committee, found $25. So, it's quite clear, the oil companies have testified to something in the neighborhood of $40 per barrel for the economic costs. So, these numbers are straightforward. They're there on the table. We have to deal with them.

And I would love to fix the supply and demand. That's tough. That's a long-term issue we've talked about. I know I can deal with the speculation if I roll up my sleeves, assert the national authority of the U.S. Government, as Professor Greenberger has suggested, to regulate the commodities that are traded here.

The United States accounts for one-quarter of all the gasoline consumed in the world. If we regulate this market well, we will whip the rest of the world into shape, as opposed to abandoning our authority to foreign governments and private corporations.

Mr. SOROS. May I——

Senator CARPER. Mr. Soros?

Mr. SOROS.—respectfully disagree with this 40–40–40, which I have now heard too many times. I just think that is an exaggeration. I think that there are very serious underlying factors for the rise in the price of oil. And, while it would be desirable to deal with the fraud on top of those factors, we should not lose sight of the underlying problems that need to be addressed, as well.

Senator CARPER. Thank you.

Thanks, Madam Chair.

Senator CANTWELL. Senator Thune?

STATEMENT OF HON. JOHN THUNE, U.S. SENATOR FROM SOUTH DAKOTA

Senator THUNE. Thank you, Madam Chair.

Let me ask that question another way. If, let's say, today a price per barrel of oil is $130. Without the role of speculation, what's that price?

Dr. COOPER. I think it goes down 25 percent, which is about $40. There's a tremendous speculative premium that's been inserted into the price of oil over the—essentially over the last 6 or 7 years.

Mr. GREENBERGER. Yes, Sunoco—ExxonMobil and, I believe, Sunoco recently said $35 to $65, $50 to $55. There are a legion of economists who believe that there is at least a one-quarter speculative premium that has nothing to do with supply demand. And given what these oil companies are saying—and, by the way, many of these oil companies are just as angry as Mr. Ramm is—they can't hedge, either. These airlines can't hedge anymore. These markets are not hedging, they're gambling casinos. They're not for commercial interests anymore. So, it would go down, and it could go down very quickly if, as Dr. Cooper said, we rolled up our sleeves. This is not a hard problem.

Senator THUNE. And I've seen different assessments, too, and attempts to quantify the impact of various parts of this equation. What—in terms of the weak dollar, what is the—what would you say is the impact on the price per barrel of oil attributable to the fact that the dollar has been substantially below where it's been, historically?

Mr. GREENBERGER. Well, I think Mr. Soros explained that about as well as it can be explained. If you're holding an asset that you control the price of, and you can drive it up—Morgan Stanley is, I am told—Senator Snowe may know better—the largest holder of heating oil in New England. They don't want to release it, because if they can control the price—and they're obviously doing a great job, Senator Snowe is telling you; in May, heating oil is going up—they don't want to exchange it for the U.S. dollar. The U.S. dollar is going down. That's a bad trade. So, what do they want to do? They want to hold it. And that is—if there is a supply demand problem, it is a question of hoarding, here. The speculators are not just placing bets in these futures markets, they're saying, "Gosh, if I can control the price of heating oil, I'm going to go out and buy heating oil." So, you have Morgan Stanley as the biggest heating oil owners in New England.

Mr. SOROS. If I may, I think it is a little misleading. The way we are presenting it now, because let us say that there is, and I believe that there is, a speculative froth in the price of oil, and it has really developed in the last few months, and you really see it. But underlying it there is this problem that the cost of replacing the existing oil supply is rising, it is becoming increasingly costly, and the oil fields are aging, in that their depletion is accelerating. And there is this upward pressure on demand—also a real force which we didn't mention—the rising standard of living in the developed world, and the—against this, if you now head into a recession, prices would—the price of oil would come down. But, once you come out of the recession, it would go up again. So, there is an underlying problem, and there is really a need to develop alternative sources of energy. We do have, also, global warming, which is a very serious problem. So, while we are focusing on the speculative excesses, we should not lose sight of these underlying problems.

Senator THUNE. And I don't disagree. There are fundamentals—market fundamentals, obviously, that are impacting this, but there's nothing that has, probably, has more of an economic impact on my state than the price of energy. I mean, we are a cold weather climate, we are a geographically dispersed population, travel long distances, and we're very—agriculture is our number one economy. So, this is an issue that we've really got to get our arms around.

Now, you—Dr. Cooper suggested the margin requirement for commodity trading among noncommercial traders should be 50 percent higher than the margin requirement for investment in stocks. Would that balance the role of speculative investment and productive investment?

Dr. COOPER. I base that number on a—I did a simple little discount question of how much a dollar depreciates over 10 years when it's put into a long-term asset versus being flipped, year after year. I did that at the two OMB-mandated discount rates, to simply get an idea of what it takes to balance the attractiveness of that short-term "flip it every year and collect the returns" versus "hold it for 10 years and earn a normal return." So, that simply reflects the time value of money between a 1-year investment and a 10-year investment. I would encourage the Committee to look for other things. We used to have a short-term capital gains tax. And

in a capitalist economy, the single most powerful instrument of directing investment is tax policy. That's basically all you've got if you want to rely on a broad market approach. So, I think that's an important thing to consider so that we rebalance the attractiveness of the short-term flipping, which is what's—became quite a phenomenon in the housing market and long-term investments. We tell consumers, "Invest long term." We have to balance this playing field so that we can get the returns on the long-term investments.

Senator THUNE. Madam Chair, I know my time's expired. I'd like to ask some more questions. Maybe I could submit those, if possible, for the record.

But, thank you all very much for your testimony.

Senator CANTWELL. Thank you, Senator Thune.

Senator Nelson?

STATEMENT OF HON. BILL NELSON, U.S. SENATOR FROM FLORIDA

Senator NELSON. Madam Chairman, I have just returned from my state of Florida, having done 18 town hall meetings, and I can tell you that people are frustrated. It doesn't make any difference if you're in the urban parts of our state or in the rural parts of our state, they're frustrated. That frustration is turning into anger, and a lot of it has to do with the price of gas. It is incumbent upon us—as I was constantly attacked in these town-hall meetings by people that were sent there by certain special interests to say, "Well, the solution is just for us to drill more." Well, of course—here's a chart. From 1994 to 2007, the red bars indicate the drilling permits that were issued. The more drilling permits that were issued in these latter years of 2004, 2005, 2006, and 2007—and you can see the graph—the price of gasoline keeps going higher and higher, which would defy those who want the easy solution of "just drill more." This is the broken record that I talk about all the time, about going to alternative sources of energy, and so forth.

Now, I want to ask these wonderful experts that we have here. What is the relationship between the fact that the federal funds rate has been dropping—on September 15, federal funds rate was at 5.25, and then it's dropped all the way to 2 percent in 9 months, and yet, can you share why, if you're making easier money, is the price of gas—is there a relation between the two?

Mr. Soros?

Mr. SOROS. It's a very, very indirect relation, because the drop in Fed funds, which reflected the slowdown in the economy, led to a decline in the value of the dollar, which then reinforced the upward pressures on us. So, that would be the connection. It's an indirect connection.

Senator NELSON. All right, and that's also, then, another way of saying that if we want to stop this indirect increased cost of oil as a result of the weakness of the dollar, ultimately we've got to get our economic house in order——

Mr. SOROS. Yes.

Senator NELSON.—and balance the budget.

All right. Mr. Greenberger, let me ask you. Is the Dubai Financial Services Authority—have they ever initiated an enforcement

action for manipulation in the commodities markets that they regulate?

Mr. GREENBERGER. In candor, I can't answer that question, but I will tell you, as a member of the Worldwide Regulator Conference, the fact that Dubai regulators would be deemed comparable to the United States is laughable. It's laughable. They may have brought enforcement actions, but, again, are you going to go to Florida and tell your constituents, "Don't worry about a thing, we've got Dubai on the case"? That'll make them angry, I think.

The second thing I do want to make clear is—well, two points. You know, this Fed funds rate issue is all—we're not talking about it today, but the subprime meltdown is integrally involved in further deregulated instruments, credit default swaps, which, prior to this passage of this 2000 act, would have had to be regulated, there would have been capital reserves, people would have been looking over people's shoulders. Those toxic instruments are now being taken, that nobody else will buy, by the United States Federal Reserve in exchange for U.S. treasuries.

And when you say about the weakening of the U.S. economy, the United States—you and I are holding those instruments as collateral for treasuries that are being given to banks. And the Fed funds rate is really a mirage. People are pulling their hair out. The true indication of what interest rates are is the London interbank daily rate, which is basis point—historically, basis points higher than the Fed funds. Why is that? Because nobody believes that they want to lend to these banks, because they are not—you know, Bear Stearns collapsed, Lehman Brothers is going out, asking for another $300 million.

So, what I'm saying to you is, your job is not just with this energy stuff. The farm crisis points back to this; the housing crisis; and if we're going to put our economy in order, yes, we should balance the budget; but we can't let this gambling casino continue and see the Bear Stearnses of this world, and other banks who are teetering on the brink and need the help of the Fed at the discount window, and raises serious problems, that's why our economic situation is held in ill repute, and why the dollar is sinking, in my view.

Senator NELSON. We had a little victory, a week and a half ago in the farm bill, on creating more oversight in the Commodities Futures Trading Commission. I take it you don't think that's going to do much for the price of oil.

Mr. GREENBERGER. Yes, because the CFTC has said it does not affect West Texas Intermediate contracts, because those—even though they're sold in the United States by United States-owned or affiliated entities, they're traded—they're controlled by London and Dubai, and you cannot use the farm bill amendment to regulate those products.

And I've earlier said, Senator Nelson—I'd be happy to talk to you further; you can read my testimony—the farm bill puts the burden on the public to prove that there's regulation. The public can't afford to go through lengthy administrative proceedings on a contract-by-contract basis. The old rule, before Senator Gramm got his CFMA through, was that the traders had to prove they should be deregulated, not that the public had to prove there should be regu-

lation. The CFTC has said that farm bill amendment will affect one out of thousands of energy contracts.

Senator NELSON. Thank you.

Thank you, Madam Chair.

Senator CANTWELL. Mr. Greenberger, I just want to be—I want to be clear, because there's something that some people might find confusing, and that is, on U.S. products, we obviously believe that if you're selling U.S. products, they ought to be regulated in the United States. And when you are—as the United States wants to do, selling in some other country, we can do that, but then we are under the regulations of those markets. Is that correct?

Mr. GREENBERGER. Well, it is correct, but it's a little more complicated than that. And, quite frankly, that led to the whole foreign board of trade issue. Some countries said, "If you lightly regulate our exchanges coming into your country, we'll lightly regulate yours." But, the fact of the matter is, that is going all in one direction. All the liquidity is in the United States. It is very important that we not just let these Dubai exchanges that have partnered with our own exchanges, or ICE, which is in Atlanta, Intercontinental Exchange, be treated by the United Kingdom—they're robbing us blind. There are no spec limits, there are no position limits, there's no large data trader reporting. That could be stopped this afternoon.

In other words, the comity we tried to create, and the fairness, has been, in the last 7 years, just made into a joke, and we've literally gotten undressed in front of the rest of the world, and let them do what they will with our gas-paying, oil-paying economy.

The final point I want to make, Senator Cantwell—and I don't want the sun to rest before I say this—I agree completely with Mr. Soros, and I don't want to be misunderstood. There are serious supply demand problems here. Environment causes—our need to control the environment causes some of it. What I am saying is, there's an unnecessary premium. And when I say things would be easy, I think we could knock that premium out overnight if people were of good faith and brought all this under the kind of regulation that this country saw for 78 years, from 1922 to 2000, control speculation. We've abandoned that completely.

Senator CANTWELL. Thank you.

I actually have a question for Ms. Watson, and that is—obviously, part of the concern that's been discussed here today is how the futures market impacts the physical supply, and that was an issue, as we saw with both Enron and Amaranth, as it relates to both electricity and natural gas markets. When we gave FERC this new authority to stop manipulation, you were able to waive the required 30-day notice and implement the rule immediately. Is that correct?

Ms. WATSON. Yes, it is.

Senator CANTWELL. And so, you were able to do that, I think, because——

Ms. WATSON. We were able to show that we had good cause. At the time, it was in early 2006, and the Katrina—of course, the hurricane that hit in 2005, we were concerned about what might be happening still, as a result, on prices, and also, it was in the middle of winter of 2006, so we asked to waive the 30-day time period

so that we could implement the anti-manipulation regulations immediately.

Senator CANTWELL. So, in effect, the FTC should be able to do the same thing. I mean, I would assume that they have even more history and knowledge, given what you've been able to accomplish in the electricity and natural gas markets.

Ms. WATSON. I can't speak for the FTC, I can only tell you what our—what we did.

Senator CANTWELL. Mr. Greenberger, would you say the FTC has a clear mandate to implement, and perhaps even to—you know, good cause to implement an interim anti-manipulation rule, given that it's such an urgent situation on prices?

Mr. GREENBERGER. Absolutely, and for several reasons. One, they're being asked to do in the crude oil markets what FERC did in the natural gas markets. FERC has already set up the template. They put out this crazy Advance Notice of Public Rulemaking that makes—and the American Petroleum Institute came out and said, "Gee, you only gave us 30 days notice." Covington & Burling came in and said, "We need 90 days to answer these questions, not 30 days." Covington & Burling could answer those questions overnight if they—if it was in their economic interest, I'll tell you that. But, the—this procedure that the FTC has set upon means there's not going to be a rule til the early fall. They have the FERC template. All the questions they've asked have been answered by FERC. They don't need this fancy-dancy academic exercise.

And number two is their good cause—the FERC representative talks about Katrina and what was happening in 2006. Senator Nelson, what's happening in 2008? This is a national crisis. There is room in the Administrative Procedures Act for good cause, when the public will be harmed by delay, for the agency to move quickly. I've put this in my testimony. The FTC, quite frankly, should be kicked in the rear end and get them moving on this thing.

Senator CANTWELL. Thank you.

Senator Dorgan?

Senator DORGAN. Mr. Greenberger, are we likely to expect the current head of the CFTC to address these problems aggressively?

Mr. GREENBERGER. Well, he certainly tried to give the appearance of it by his so-called May 29 release. I have my doubts. I think Senator Cantwell referred to this. Many of the commitments—he's dealing with an Atlanta-based exchange trading U.S. products, and he's gotten down on his hands and knees and said to the British and to this exchange, "Would you please give us the data we need?"

Senator DORGAN. Do you think he's part of the problem rather than part of the solution?

Mr. GREENBERGER. I most certainly do. I hate to say that, because I like him as a person very much. But, you must recall, he's was the Staff Director of the Committee that produced the regulation that puts us in the food crisis, energy crisis, and housing crisis we're in today. I think he has a vested interest in saying they did the right thing when they deregulated all these markets.

Senator DORGAN. The cost of ineffective regulators—the cost of regulators who come to government, not liking government, and wanting not to regulate, is dramatic. We've seen it in the Enron scandal, we've seen it, in my judgment, now with those in a regu-

latory capacity who are supposed to be the referees. After all, a free-market system works only if you have referees to call the fouls. We have seen now plenty of evidence that those who have come to government not believing in the central mission of the agency they run have done great damage to our economy.

Mr. Soros, I have read your most recent book, and, in fact, was writing a piece, myself, on credit default swaps and those kinds of issues the other evening, and especially about hedge funds, generally. And then I saw your income last year. I was going through *Alpha* magazine. And you did very well last year, $3 billion. That's $250 million a month in income, running a hedge fund. Is that correct?

Mr. SOROS. Yes, that is——

[Laughter.]

Mr. SOROS.—that was why——

Senator DORGAN. That's pretty well defined as "success," I would guess.

I also—is any of that coming from speculative trading in oil contracts?

Mr. SOROS. No.

Senator DORGAN. OK.

Mr. SOROS. No, I'm not a participant in the oil——

Senator DORGAN. I did read, recently—and I don't know whether it was an interpretation of what you said or what you said—I did read that you were reported to have said, "This bubble will burst, the current price of oil is not destined to remain"—that this is a bubble, and it will burst. Is that an accurate reflection of what you——

Mr. SOROS. No, I think it was——

Senator DORGAN.—think will happen?

Mr. SOROS. That was probably a distortion of the testimony which I gave today, which is really that there is a bubble element. There's a froth. But, also there are some fundamental factors behind it.

Senator DORGAN. Yes. And I don't think there's disagreement about that. There is the general issue of energy, supply demand, you know, 300 million additional Chinese and citizens of India that are going to drive vehicles, and they're going to need to fuel them, and so—so, I understand all that. But, this issue today is about, What is the speculation, on top of that, that's driven these prices up?

Mr. Greenberger, I want to ask you a question that you referred—you referred to this, just briefly. We have been told, "If you increase the margin requirements for these contracts in this country from 5 to 7 percent, increase those margin requirements somewhere up the line, this will just all migrate and it'll—all this business is going to migrate." You say that's total nonsense. Describe to me why that's nonsense.

Mr. GREENBERGER. Well, first of all, if spec limits were in place, some of that business wouldn't be here, to begin with. In other words, as Mr. Soros has said, I believe, and as I'm saying, is—we have too many speculators, these markets are dysfunctional. For 78 years, we limited speculation. So, it's got to migrate, to bring the markets back into shape.

But, second, Senator, I have—will tell you, every exchange—I have this detailed in my testimony—any worldwide exchange worth its salt wants U.S. terminals, they want to be in the United States. And when they say they're going to migrate, what they tell you is, "Well, we're using computer terminals, but we're going to come up with a fancy technology that you don't even know about. We'll sit on Wall Street and appear to trade in London and Dubai, and therefore, you'll lose this business." It is a classic proposition of the Justice Department, of which I happily served, and the Commodity Futures Trading Commission, that if you distort our markets illegally, wherever you are in the world, we will come after you and prosecute you. Maybe you'll go, like Mr. Vesco, somewhere where we can't extradite you, but if you can be extradited, you're going to be brought back. So, if these guys, who are sort of sticking it in the—their finger in the face of the American consumer, saying, "Don't regulate us or we'll leave the country"—if they leave the country, and they do this, an aggressive, effective regulator or prosecutor will hunt them down and bring them back. They can't escape our regulatory mechanism. And I think——

Senator DORGAN. But——

Mr. GREENBERGER.—it's an insult and disloyal to the United States of America to say, "To help the consumer will drive us to go elsewhere and hurt the American economy."

Senator DORGAN. But, they say they can escape because you can't see them and you can't find them. It's also the case, isn't it, that, at least a sizable American company was one of the founders of the Intercontinental Exchange. So, the point is that they say—those of us that have said—and I've been speaking on the floor about this a lot, about the need to increase the margin requirement—they say, "You do that, number one, and you'll just drive these folks back into the shadows, and you won't find them." You're saying that that's—that that cannot, and will not, be the case.

Mr. GREENBERGER. The founders of the Intercontinental Exchange were Goldman Sachs, Morgan Stanley, and British Petroleum. Our—what—if—you know, if they go—first of all, those guys aren't going to abandon their summer homes in the Hamptons, I can assure you that; they're going to be here. They're going to be trading here. If they pick up the phone and call in an order to London, they're trading in the United States, and they're subject to regulation. They will not, they cannot—and the further point is, it is an economic reality of these markets that you cannot maximize your profits, or, for that matter, even create liquidity, unless you're here in the United States. Eighteen of these exchanges came, on their hands and knees. I had the head of the London International Futures Exchange in tears because we weren't letting him trade in the United States fast enough.

Senator DORGAN. I want to have further conversation with you at some point this week, if I might, but I——

Mr. GREENBERGER. Sure.

Senator DORGAN. Let me just thank all of the witnesses. I think it's been a good hearing, and I appreciate it.

Senator CANTWELL. Thank you.

Senator Klobuchar?

Senator KLOBUCHAR. Thank you.

Mr. Soros, you talked about peak oil, and I know that Senator Nelson asked you some questions about drilling. This is something people bring up all the time in my state that maybe we can get more drilling going. And there is some more going, say, in Senator Dorgan's state of North Dakota; there are some efforts that we're supportive of. But, this idea that the known oil reserves are being depleted, that our country only has 2 percent, I believe, of the oil reserves—you say that the word "peak oil" is misleading. Do you want to elaborate on that a little on this line of issues?

Mr. SOROS. Yes. "Peak oil," taken literally, means that at some point the total volume of production declines. And that may not be the case, because if you spend more money, you can always—not always, but you can still increase production. "Peak oil"——

Senator KLOBUCHAR. This is like an enhanced——

Mr. SOROS.—is a misleading word. But, the underlying fact is that most of the existing oil fields are now aging, and the rate of depletion increases as they get older. And you—because of the rise in demand and the rise in the price, we now use various techniques of recapturing more oil. That has a tendency to sort of come to a certain sharp point where suddenly the oil field runs out. So, for instance, in Mexico there's a very large oil field where the production has dropped by 25 percent in 1 year. So, depletion is a very big problem.

And, at the same time, of course, you have to go deeper and deeper in for instance, in Brazil there's a major new discovery. It's the most important new oil field that has been found in many years. But, it's extremely difficult to reach, and it's going to be very expensive to exploit.

So, these are the basic facts. And there is something like "peak oil" that is occurring, and when you add to that the very real problem of global warming, which, could be fatal to our civilization, we must develop alternative supplies of energy, other than oil, and there is no escape from that. And probably cheapest and most abundant source of alternative energy is coal, but coal is extremely polluting. There are ways of taking carbon out of coal; however, that costs money. And you don't, at the present time, have a price on carbon that would justify taking carbon out of coal. That is a problem that is confronting us, and we have not dealt with it. And that, in my mind, overshadows everything else.

Senator KLOBUCHAR. Right. I think one of the things we're trying to get at here is—you know, people I—talk about it in Minnesota, but also that there's money that's going to places that it probably shouldn't. But, maybe we can fuel it into what you're talking about, this development of new technology and cleaner coal and solar and wind. And that's what we're trying to get at. And we've been, as you know, blocked, time and time again in Congress right now, from doing that. And I just wondered——

Mr. SOROS. But, you know——

Senator KLOBUCHAR. Go ahead.

Mr. SOROS.—it does mean that the cost of energy is going to be higher. We have to bite the bullet, as far as that is concerned, and we have to adjust our way of life.

Senator KLOBUCHAR. I think that people have gone beyond Jimmy Carter with the sweater, gloomy, saying that conservation

is going to be hard. I think that they see this as a huge economic burden to them right now, and they are more interested in looking at whatever it is, mass transit or different things. We just—their report came out today, 10 percent increase in mass transit as ways of dealing with this. But, I just wanted to get, quickly, your response to what Mr. Greenberger says, as we get pushback on the margin, the ideas of increasing the margin, or also on further closing the Enron loophole for crude oil and the pushback that Mr. Greenberger has mentioned, his company saying, "Oh, we're going to take our business elsewhere and it'll hurt your economy even more." I just wondered how you would respond to that.

Mr. SOROS. Yes. I think that it won't be quite as easy as Mr. Greenberger said to regulate the unregulated oil market, because the oil market is an international market, and trades take place all over the world. So, while it may be possible to—and I think the American institutions that are, let's say, now accumulating oil as an asset class, could be regulated, and they could be brought under regulation, and that would make a very big difference. I think other—actually, bringing hedge funds—many of them not domiciled in the United States, many of them not run by people in the United States—under the same kind of controls would be much more difficult.

Senator KLOBUCHAR. Thank you.

Dr. COOPER. Senator, one observation.

Senator KLOBUCHAR. Dr. Cooper?

Dr. COOPER. It would be infinitely easier to convince the American people to spend $40 a barrel to address the environmental and social costs of energy consumption if we weren't spending $80 a barrel on speculation and the abuse of market power. So, we really do have to keep these two things separate.

Senator KLOBUCHAR. Right.

Dr. COOPER. I agree entirely that energy is—we really do have to recognize the social costs, but that doesn't mean we should pay the ransom that's being extracted from us now.

Senator KLOBUCHAR. Agreed.

Senator CANTWELL. Thank you.

Senator KLOBUCHAR. Thank you.

Senator CANTWELL. Thank you.

Senator Nelson, last question.

Senator NELSON. I agree about the ransom that we're paying, and you all have been wonderful in your presentation here to make it very clear about this speculation. But, at the end of the day, what we have to have is the political will to start weaning ourselves from dependence on oil and go to the alternatives. We had a wake-up call in the early 1970s. We went back to sleep. We had a wake-up call in the late 1970s. We went back to sleep. We had another wake-up call in the late 1980s, early 1990s, and we went back to sleep. Now, early in this decade we had another wake-up call that's still continuing, and the question is, are we going to go back to sleep?

The bottom line—and this is my question—isn't it going to take the new President to say that we're going to have the equivalent of an Apollo program, and that we are going to break this dependence on, especially, foreign oil?

Mr. SOROS. I think, yes.

Dr. COOPER. If you look at the cost of the climate change legislation before—being considered by the Senate as we speak—I added up the numbers, and it's almost $5 trillion over about 40 years. So, the Senate is now contemplating programs of an immense order of magnitude. We're going to wrangle about how the consumer's going to bear that cost. But, the Congress has finally begun to have this debate. All of the Presidential candidates have said they understand that there's a problem here. So, in fact, we may be—we may have wasted a long time, but, you know, the—all the evidence suggests that we're getting ready to grapple with this really difficult issue.

Senator NELSON. I'll end on a good note, Madam Chair.

You know, for each of the 8 years that you and I have been in the Senate, we have tried to increase miles per gallon, and we have always been defeated in the fleet average. We were operating on a standard that didn't mean anything, because it was 25 miles per gallon from 1980s, but light trucks and SUVs were exempt, so it didn't mean anything. Every year, we offered it, and we were beat. But, we finally won, a modest increase of only 35 miles per gallon phased over the next 12 years, to 2020, but at least we succeeded with a modest increase. I hope that's a foretelling of things to come.

Thank you.

Senator CANTWELL. Well, I thank Senator Nelson and all the members for attending hearing.

And I certainly want to thank the panel and—for their testimony. Mr. Soros, Mr. Greenberger, Mr. Ramm, Ms. Watson, Dr. Cooper, thank you very much for being here.

We will continue this discussion. I plan to continue to push the CFTC on their "no action" letter, and certainly on the FTC in getting an interim rule in place. But, we thank you for illuminating this issue for so many of us in the U.S. Senate, and certainly for our constituents.

This hearing is adjourned.

[Whereupon, at 12:17 p.m., the hearing was adjourned.]

APPENDIX

PREPARED STATEMENT OF HON. BARBARA BOXER, U.S. SENATOR FROM CALIFORNIA

As we head into the summer travel season, Americans are faced with rising unemployment rates, fallout from a widespread housing crisis and gas prices exceeding $4 per gallon.

Californians are now paying more for our gas than any other state in the country, with the average price of a regular gallon of gasoline topping $4.40 per gallon.

We know there are several factors contributing to the rise in oil prices and gas prices nationwide—increased demand for oil in growing economies such as China and India, conflict in oil producing regions that has had a destabilizing effect on the market, a weak dollar, and a failed energy policy on the part of our current Administration that has lacked the vision to invest in renewable energy and other alternatives.

In addition to these factors, the high price of energy commodities has also contributed to high oil prices. I am greatly concerned about the impact of market speculation on the price of oil. In the past year, we have witnessed the price of oil nearly double and analysts now predict the price of a barrel of oil could reach $150 by the Fourth of July holiday.

In Congress, I have joined with my colleagues to call on the President to cease filling the Strategic Petroleum Reserve and supported the inclusion of provisions in the Energy Independence Security Act (EISA) to give the Federal Trade Commission authority to prohibit market manipulation and the reporting of false information in wholesale petroleum markets.

I also believe the Commodities Futures Trading Commission (CFTC) needs to be given the authority once again to regulate energy futures contracts to prevent the rampant trading that has driven the price of oil well beyond normal supply and demand costs.

I look forward to working the Members of this Committee on this and other possible solutions to try to address the growing energy crisis.

Thank you, Mr. Chairman.

PREPARED STATEMENT INTERCONTINENTALEXCHANGE, INC. (ICE) AND ICE FUTURES EUROPE

IntercontinentalExchange, Inc. (ICE) and ICE Futures Europe are pleased to provide a statement in response to testimony provided at the June 3, 2008 Senate Hearing held by the Committee on Commerce Science and Transportation. ICE strives to demonstrate leadership in supporting efforts of both the U.S. Commodity Futures Trading Commission (CFTC) and Congress further enhancing market transparency. Over the past decade we have taken efforts to consciously build our marketplace on the cornerstones of integrity, transparency and neutrality. To do otherwise would be unworkable both from a customer acceptance and a regulatory perspective. ICE has been instrumental in developing a number of transparency initiatives from which the industry has benefited in the past several years. Today we operate a global marketplace that includes three fully regulated futures exchanges and a transparent over-the-counter (OTC) market, which will soon be regulated according to commodity trading provisions in the 2008 Farm Bill.

As a member of the financial services community and a close observer of the global energy market, ICE would like to respond to certain misconceptions regarding our business and markets and issues related to this hearing. In particular, there has been significant interest in Congress with the ICE Futures Europe listing of its cash-settled West Texas Intermediate (WTI) crude oil contract.

ICE purchased the International Petroleum Exchange (IPE) in 2001. This has remained a U.K.-based exchange, now called ICE Futures Europe, and is fully regulated by the Financial Services Authority (FSA). The FSA has a wide range of rulemaking, investigatory and enforcement powers and strives to meet four statutory objectives:

- maintaining confidence in the financial system;
- promoting public understanding of the financial system;
- securing the appropriate degree of protection for consumers; and
- reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime.

Since the WTI contract's inception, ICE has taken proactive measures to ensure that the FSA and CFTC, have had adequate data to monitor ICE's markets across borders. A primary focus of the FSA is on cooperating with overseas regulators, both to agree on international standards and to monitor global firms and markets effectively. In 2006 the information sharing agreement between the CFTC and the FSA with regard to ICE's markets was re-examined and reaffirmed.

This cooperation has now been enhanced through the information sharing agreement between the CFTC and the U.K. Financial Services Authority (FSA) that was announced on May 29, 2008. In modifying the existing memorandum of understanding between the CFTC and the FSA, ICE Futures Europe is the only oil futures exchange globally that reports information to both the CFTC and FSA. As a result of the agreement, ICE provides equal or greater disclosure for its markets than U.S.-based exchanges. Specifically, ICE has agreed to undertake, or develop the means to undertake, the following immediately:

1. Provide daily large-trader positions to the CFTC in all U.S. futures contracts, including the West Texas Intermediate (WTI) crude oil contract;
2. Extend the data currently provided to cover all contract months;
3. Provide trader information to ensure detailed identification of market end-users;
4. Provide data formatting so trading information can be seamlessly integrated into the CFTC's existing surveillance system; and
5. In addition to the existing position management program that FSA requires of ICE Futures Europe today, ICE Futures Europe will monitor positions to detect those that exceed the same accountability limits as employed by U.S. contract markets in its U.S. products and to give timely notification to the CFTC when that occurs.

ICE Futures Europe has a well-established position monitoring regime that is rigorously enforced both at the exchange level and by the FSA. The FSA can and will require positions to be reduced if deemed necessary. Added to this, the market surveillance staff at ICE Futures Europe performs comprehensive monitoring in real-time across all of its markets and will notify the CFTC if speculative position accountability limits are exceeded in the WTI contract. In essence, all U.S. contracts, including WTI, offered in our markets are now monitored by two regulators.

We would also like to highlight what we believe are some misperceptions about the products that actually trade on our exchange. The futures products traded at ICE Futures Europe and governed by the aforementioned regulatory regime include: Brent Crude oil, West Texas Intermediate (WTI) Crude oil, Gas Oil, Heating Oil and Emissions, as well as several other U.K. or Europe-specific gas and power offerings. It is important to make the distinction that ICE's OTC markets which were the subject of provisions in the 2008 Farm Bill have less than 1 percent market share in both the physically-delivered OTC markets and in the cash-settled "swaps" market for coal, crude oil, U.S. gasoline, heating oil, and diesel fuel. Further, we maintain an approximately 25 percent market share for WTI Crude oil, with the majority of this volume coning from U.K.-based trading. The vast majority of WTI trading volume occurs on NYMEX. Importantly, the price of U.S. gasoline and heating oil is discovered on NYMEX, and not on our exchange, where our market share in these products is less than 1 percent of total contract volume.

While there has been significant focus recently on the price of oil and related products, it is important to note that prices for all commodities, such as corn, soybeans, precious metals and wheat, have surged at the same rate as crude oil, and in some cases more sharply and with greater volatility. It should be noted that in most of these commodity products, except in crude oil, where ICE and NYMEX have coexisted for more than 25 years, there are no major overseas markets offering commodity contracts to U.S. markets. These facts indicate that the existence of overseas markets cannot bear the blame when it comes to higher prices. While it is tempting to criticize the markets who deliver pricing signals, economists continue to agree that the primary driver of commodity prices across the board is a well-documented expansion in demand for the building blocks of emerging economies.

Finally, we would like to point out that the issue of foreign boards of trade and the no-action process was fully and carefully evaluated by the CFTC at the end of

2006 and information sharing protocols were established to provide U.S. regulators with the very information certain Congressional representatives say they need to do their job. Both ICE and NYMEX operate liquid, transparent futures exchanges that serve the important function of price discovery for the world's oil markets. Onerous or selectively applied regulation could easily lead oil market participants to conduct their business off-exchange in the opaque, voice-brokered markets. This would truly represent a shift to "dark markets".

JOINT ANALYSIS PREPARED BY MAJORITY AND MINORITY STAFFS OF THE SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS OF MICHAEL GREENBERGER'S TESTIMONY BEFORE SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION ON JUNE 3, 2008

June 24, 2008

Because many questions have been directed to the Senate Permanent Subcommittee on Investigations (PSI) about the written and oral testimony of Michael Greenberger before the Senate Committee on Commerce, Science and Transportation on June 3, 2008, we have prepared this analysis of the major issues he raised involving: (1) the recently enacted law to close the "Enron loophole," and (2) recent legislative proposals and administrative actions taken to strengthen U.S. oversight of futures contracts traded from within the United States on a foreign exchange.

The identified statements are excerpted from Mr. Greenberger's oral testimony or, where a page number is provided, from his prepared statement.

Issues Related to Closing the Enron Loophole

1. STATEMENT: *"[The legislation to close the Enron loophole]. . .is the biggest joke in the world because it was written by the exchange that needs to be regulated."*

STATEMENT (p. 3): *"Virtually all parties now agree the Enron loophole must be repealed."*

RESPONSE: The legislation to close the Enron loophole was written by the U.S. Congress, not the Intercontinental Exchange. Closing the Enron loophole has been the subject of repeated bills introduced on this subject since 2002. In the fall of 2007, following a PSI report and hearings on excessive speculation and the resulting move in Congress toward legislative reforms, the Commodity Futures Trading Commission (CFTC) and the President's Working Group (consisting of the Departments of Treasury, the Federal Reserve, the Securities and Exchange Commission, and the CFTC) submitted to Congress draft legislation to close the Enron loophole. That draft underwent significant revision during the legislative process, including numerous significant changes proposed by Senators Levin, Feinstein, Snowe, Coleman and others. The final language was the product of extensive bipartisan negotiations in both Houses of Congress and a conference committee led by the House and Senate Agriculture Committees. Throughout the legislative process ICE expressed numerous disagreements with many of the provisions in the various drafts of this legislation. The final legislation did not include many of the provisions that ICE had sought.

The compromise legislation finally enacted into law as part of the Farm Bill enjoyed strong bipartisan support from Members in both Houses and from many energy, agricultural, consumer, and industrial organizations. [1] We are unaware of any consensus to alter this legislation, which represents a bipartisan achievement after years of work.

2. STATEMENT: *"The End the Enron Loophole, because it was written by the Intercontinental Exchange, handed to the CFTC and then handed to Congress, does not deal with crude oil."*

STATEMENT (p. 4): *"Thus, by CFTC pronouncement, crude oil, gasoline and heating oil futures will not be covered by the new legislation."*

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[1] This legislation was supported by the American Public Gas Association, American Public Power Association, Consumer Federation of America, Environmental Defense, Industrial Energy Consumers of America, Independent Oil Marketers Association of New England, Mid-Atlantic Petroleum Distributor's Association, National Association of Convenience Stores, National Association of Truck Stop Operators, National Association of Wheat Growers, National Barley Growers Association, National Farmers Union, National Grange, National Rural Electrical Cooperative Association, New England Fuel Institute, Pacific Northwest Oilheat Council, Petroleum Marketers Association of America, Petroleum Transportation and Storage Association, Public Citizen, Society of Independent Gasoline Marketers of America, Steel Manufacturers Association, and Western Petroleum Marketers Association.

RESPONSE: These statements are incorrect or may leave an incorrect impression. The law enacted by Congress to close the Enron loophole regulates the electronic trading of all types of energy and metal commodities on Exempt Commercial Markets without exception, including crude oil, gasoline, and heating oil, if the relevant contracts perform a significant price discovery function. The CFTC has not made any statements or decisions to exempt any class of commodities or energy contracts from CFTC oversight under the new law. At the same time, as a practical matter, the new law will not affect current trading of U.S. crude oil, gasoline, and heating oil futures contracts—not because of who drafted the law or because of any gaps in the legislation—but because futures contracts in those commodities are not currently being traded on U.S. Exempt Commercial Markets. Rather, futures contracts in these commodities are being traded on futures exchanges in the United States and United Kingdom. Should any of those energy commodities ever be traded on Exempt Commercial Markets, the new law makes it clear that the CFTC will be able to exercise oversight over them. As a result of the legislation to close the Enron loophole, traders will no longer have the opportunity to trade crude oil, gasoline, or home heating oil on U.S. electronic markets without CFTC oversight.

3. STATEMENT (p. 4): *". . . the Farm Bill amendment requires the CFTC and the public to prove on a case-by-case basis through lengthy administrative proceedings that an individual energy contract should be regulated if the CFTC can prove that contract 'serve[s] a significant price discovery function' in order to detect and prevent manipulation."*

STATEMENT: *"[The legislation to close the Enron loophole] puts 1,000 burdens on the CFTC and the public to prove that there needs to be regulation."*

STATEMENT: *"[The CFTC] has to go through complicated administrative hearings, which I can tell you will be challenged vigorously by people who can afford to make those challenges, and will have to prove by substantial evidence that that contract will be regulated."*

STATEMENT (p. 4): "It will doubtless be followed by lengthy and costly judicial challenges during which the CFTC and energy consuming public will be required to show that its difficult burden has not been met."

RESPONSE: These statements are incorrect. The new law does not place any burden on the public, does not require extensive administrative proceedings to determine that a contract performs a significant price discovery function and is subject to CFTC oversight, and does not authorize judicial challenges to CFTC decisions in this area. To the contrary, the law explicitly gives the CFTC the "discretion" to determine which contracts perform significant price discovery functions and are subject to CFTC oversight. The statute and legislative history make it clear that formal administrative proceedings are not required and judicial challenges are not permitted. For example, during the Senate's consideration of the legislation, Senator Levin explained:

> The legislation also states clearly that a CFTC determination that a contract performs a significant price discovery function is a determination that is within the Commission's discretion; this determination is not intended to be subject to formal challenge through administrative proceedings."
>
> The Statement of Managers in the Conference Report states:
>
> "The Managers do not intend that the Commission conduct an exhaustive annual examination of every contract traded on an electronic trading facility pursuant to the section 2(h)(3) exemption, but instead to concentrate on those contracts that are most likely to meet the criteria for performing a significant price discovery function.

The law directs the CFTC to determine which contracts are performing significant price discovery functions within 180 days of promulgating regulations setting forth the criteria to be considered when evaluating individual contracts.

4. STATEMENT: *"The CFTC has said that farm bill amendment [sic] will affect one out of thousands of energy contracts."*

STATEMENT (p. 4): *"This contract-by-contract process will take months, if not years, to complete and it will then only apply to a single contract."*

RESPONSE: These statements are incorrect. The CFTC has not made any statements or provided any indication of the number of commodities or contracts that will likely be determined to perform a significant price discovery function. The CFTC certainly has not indicated that only one contract will be covered. To the contrary, informed observers indicate multiple contracts are likely to qualify for CFTC oversight.

5. STATEMENT (p. 4): *"Moreover, the Farm Bill's attempt to end the Enron Loophole will doubtless lead to further regulatory arbitrage. If the CFTC should be able to*

prove that an individual energy futures contract has contract has [sic] a 'significant price discovery function,' and thus should be subject to regulation, traders will almost certainly simply move their trading to equivalent contracts that remain exempt from regulation."

RESPONSE: Mr. Greenberger appears to be predicting that if the CFTC determines that one particular contract performs a significant price discovery function, then traders will begin trading a different contract that hasn't been deemed to perform a significant price discovery function and isn't subject to CFTC oversight. Practical obstacles and the design of the new law, however, make this type of maneuvering unlikely.

First, it is much more difficult for a trader to use a contract that does not perform a price discovery function since, by definition, it will have a lower trading volume and fewer counterparties. During the PSI Amaranth investigation, numerous traders told the Subcommittee that the most significant factors in determining which market and contract to use for trading were price and liquidity. All of the traders interviewed by the Subcommittee stated that they would trade the contract that provided the best price and most liquidity, regardless of whether it was in a regulated or unregulated market. Second, if a significant amount of trading did migrate from a regulated contract to an unregulated contract simply to avoid regulation, the CFTC could readily determine that the second contract also performed a significant price discovery function and regain its ability to exercise oversight. In fact, one of the statutory factors for determining whether a contract performs a significant price discovery function is whether that contract is being used for arbitraging purposes. The new law thus contains provisions designed to prevent exactly the type of arbitrage scenario Mr. Greenberger describes.

6. STATEMENT: *"I would go back to the status quo ante before the Enron loophole was passed."*

STATEMENT (p. 5): *"Again, the easiest course to end the Enron loophole was not chosen as part of the Farm Bill. The most effective closure would have simply returned the Commodity Exchange Act to the status quo ante prior to the passage of the Enron loophole."*

STATEMENT (p. 3): *"The simplest way to repeal [the Enron loophole] would be to add two words to the Act's definition of 'exempt commodity' so it reads: an exempt commodity does 'not include an agriculture or energy commodity;' and two words to 7 U.S.C.* § 7(e) to make clear that 'agricultural and energy commodities must trade on regulated markets.'"

RESPONSE: Mr. Greenberger seems to be proposing a return to the legal framework for commodity trading prior to enactment of the Commodity Futures Modernization Act (CFMA) of 2000, and to require energy and metal commodities to be traded in the same way as agricultural commodities, which means they could not be traded on electronic exchanges other than a futures exchange. This approach would prohibit energy traders from trading financially settled swap instruments on electronic exchanges that are not futures exchanges, even though under the legislation the trading of significant price discovery contracts on these electronic exchanges will be regulated just like futures contracts. At the same time, the proposal would continue to permit those traders to trade these swap instruments amongst themselves by unregulated non-electronic means, such as through voice brokers, large financial institutions that operate as swap "dealers," and directly between each other using telephones and fax machines.

One of the problems with this approach is that it would re-direct trading from electronic exchanges that promote price transparency and cleared trades, two mechanisms that increase market efficiency and stability, toward greater use of unregulated, non-transparent, and non-cleared trading of swaps that impair price transparency, increase systemic risk, and make it harder to detect and prevent manipulation. It is partly because financially settled swaps do not require the physical delivery of a commodity, and partly because of the historic inability of the futures exchanges to develop active markets for more specialized types of financial and energy swaps, that Congress has never required them to be traded on fully regulated futures exchanges. To do so now would constitute a major change in U.S. commodity law, and would go much further than the status quo ante prior to the CFMA. In addition, eliminating electronic exchanges open to large traders would dismantle an accepted commodity market mechanism—the significant portions of which are now regulated—for little apparent regulatory gain.

7. STATEMENT: *"Prior to the [Enron loophole], every futures contract—oil, collateralized debt obligations, credit default swaps—had to be traded pursuant to regulation that had age-old and time-tested controls on speculation."*

RESPONSE: This statement is incorrect. Prior to the Commodity Futures Modernization Act (CFMA), large traders trading financial instruments like collateralized debt obligations, credit default swaps, and energy swaps were eligible for the hybrid and swaps exemption from the requirement that all futures contracts be traded on a regulated futures exchange. See, *e.g.,* 17 C.F.R. Part 35 (Exemption of Swap Agreements). Persons trading swaps under the various preCFMA swaps exemptions were not subject to speculative position limits.

8. STATEMENT: *"Overnight, [prohibiting the trading of energy commodities in Exempt Commercial Markets] will bring down the price of crude oil, I believe, by 25 percent."*

RESPONSE: According to recent market data, there is little to no trading of crude oil contracts on exempt commercial markets in the United States. Prohibiting the trading of energy commodities in a market in which no trading is currently taking place is, thus, unlikely to have an effect on the price of crude oil. Moreover, although there have never been any Exempt Commercial Markets for agricultural commodities, many agricultural commodities have recently experienced substantial price spikes. There is no credible evidence that simply amending the CEA to regulate energy commodities as if they were agricultural commodities will lead to lower energy prices.

Issues Related to Closing the London Loophole

9. STATEMENT: *"[B]ecause of that Enron loophole, which I believe has not been closed for crude oil, there are no speculation limits in these markets that are unregulated."*

RESPONSE: The Enron loophole has been closed for all energy and metal commodities, including crude oil traded on Exempt Commercial Markets in the United States. But currently, crude oil is not being traded on those markets.

Crude oil is instead being traded on the NYMEX exchange in New York, which has speculative position limits, and on the ICE Futures Europe exchange in London, which does not. The ICE Futures Europe exchange in London has no speculative position limits, because until recently neither the British Financial Services Authority (FSA) nor ICE Futures Europe had imposed them for U.S. crude oil contracts traded on that exchange.

Since 1982, Section 4 of the Commodity Exchange Act has authorized U.S. persons to trade on foreign exchanges and has prohibited the CFTC from imposing regulatory requirements upon those foreign exchanges. Recently, this CEA exemption has been referred to as the London loophole, since it allows U.S. traders to trade on the ICE exchange in London without CFTC oversight and without speculative position limits. On June 16, 2008, in response to concerns expressed about the London loophole, the CFTC announced that ICE Futures Europe would have to implement speculative position limits in order to be able to continue to offer U.S. traders the option of trading its U.S. crude oil contract through U.S.-based trading terminals. The CFTC is also working with the FSA on an agreement to impose speculative position limits on this contract and to alert the CFTC when any trader has exceeded those limits.

10. STATEMENT: *"There is now nothing in the law that sanctions foreign board of trades in the United States trading U.S. products being able to escape regulation. . . . What is now in my belief, illegal, and will soon, if somebody wakes up, be invalidated by either a private individual being hurt by it or a state attorney general."*

STATEMENT (p. 5): *"These staff no action letters have been referred to as Foreign Board of Trade exemptions (FBOTs)—a term which as of today is nowhere found in the CEA."*

STATEMENT (p. 12): *"[T]here is no statute to date that provides any exemption for U.S. trading on Foreign Boards of Trade. The Commodity Exchange Act says nothing about Foreign Boards of Trade."*

RESPONSE: These statements are incorrect. The Commodity Exchange Act (CEA) explicitly excludes trading on a foreign board of trade from key CFTC regulations. Section 4(a) of the CEA explicitly exempts from the requirement that all futures contracts be traded on a CFTC-regulated futures exchange contracts traded on or subject to the rules of any board of trade or exchange "located outside the United States." Section 4(b) prohibits the CFTC from issuing any regulation that approves or "governs in any way any rule or contract, rule, regulation, or action of any foreign board of trade."

11. STATEMENT (p. 5): *"It has been a fundamental tenet, recognized by exchanges all over the world, that if the trading of futures contracts takes place within the United States, that trading, unless otherwise exempted or excluded by the Act itself or by the CFTC through an exemption granted pursuant to the Futures Trading*

Practices Act of 1992 (otherwise referred to as section 4(c)) ,is subject to the regulatory jurisdiction of the Commodity Futures Trading Commission. Recognition of that sweeping reach of U.S. jurisdiction is evidenced by the fact that most major foreign futures exchanges have asked the CFTC for an exemption from the full regulatory requirements of the Commodity Exchange Act (CEA) to which they might otherwise be subject in order to allow those foreign entities to conduct trading in the U.S. on U.S.-based terminals of foreign delivered futures contracts. That exemption, premised on section 4(c), has been issued to many foreign exchanges through staff no action letters, which permit trading on a foreign exchange's U.S.-based terminals without that exchange being subject to U.S. statutory or regulatory requirements."

RESPONSE: These statements mischaracterize the statutory and legal basis for the CFTC's determination to permit foreign exchanges to operate trading terminals in the United States without being subject to full CFTC regulation as a futures exchange. The basis for the CFTC's determination to grant a foreign board of trade or exchange permission to operate trading terminals in the U.S. without being subject to the full regulatory requirements applicable to U.S. futures exchanges is not Section 4(c) of the CEA or Futures Trading Practices Act, but rather CEA Section 4(a). Section 4(a) provides that all futures contracts traded in the United States must be traded on a regulated exchange *other than contracts traded on or subject to the rules of a board of trade or exchange located outside the United States.* 7 U.S.C. § 6(a). Futures contracts traded from within the United States on a foreign exchange are, thus, excluded by statute from the requirement that futures contracts traded in the United States be traded on a futures exchange regulated by the CFTC.

12. STATEMENT (p. 6): *"This exemption was entirely the creation of CFTC staff and it has never been formally approved by the Commission itself."*

RESPONSE: This statement is incorrect. The decision to allow foreign exchanges to establish trading terminals in the United States and to permit trading on those terminals outside of CFTC oversight was formally approved by the CFTC in a Policy Statement issued on November 2, 2006. The 2006 Policy Statement was issued after a process in which the CFTC sought public comment, received written comment letters, and held a public hearing on the issues raised. In the Policy Statement, the CFTC wrote:

> "The Commodity Futures Trading Commission is issuing a Statement of Policy that affirms the use of the no-action process to permit foreign boards of trade to provide direct access to their electronic trading systems to U.S. members or authorized participants, and provides additional guidance and procedural enhancements." [2]

13. STATEMENT (p. 6): *"The staff FBOT no action letter process never contemplated that an exchange owned by or affiliated with a U.S. entity would escape the CFTC regulation imposed on traditional U.S. exchanges."*

RESPONSE: This statement is incorrect. In its 2006 Policy Statement, the CFTC determined it would not be appropriate to use any "bright-line" test based on the location of an affiliate or related corporate entity to determine whether to treat an entity as a U.S. or foreign exchange. Instead, the CFTC adopted a flexible approach that considered the totality of circumstances for determining whether an exchange was foreign or domestic, including whether the exchange was affiliated with a U.S. exchange. This approach was favored by most of the comments received by the Commission on this issue.

14. STATEMENT (p. 3): *"For purposes of facilitating exempt natural gas futures, ICE is deemed a U.S. 'exempt commercial market' under the Enron loophole. For purposes of its facilitating U.S. WTI crude oil futures, the CFTC, by informal staff action, deems ICE to be a U.K. entity not subject to direct CFTC regulation even though ICE maintains U.S. headquarters and trading infrastructure, facilitating, inter alia, at 30 percent of trades in U.S. WTI futures."*

RESPONSE: The statement gives the inaccurate impression that a single legal entity named "ICE" operates two exchanges, one in the United States and one in London, and is being treated differently depending upon which exchange is at issue. In fact, the legal entities that operate these two exchanges are different.

The legal entity that operates the electronic exchange within the United States is the Intercontinental Exchange ("ICE"). ICE is a Delaware corporation located in Atlanta, Georgia. ICE pays U.S. taxes, uses U.S. employees, and operates an exempt

[2] Commodity Futures Trading Commission, Policy Statement, *Boards of Trade Located Outside of the United States and No-Action Relief From the Requirement To Become a Designated Contract Market or Derivatives Transaction Execution Facility,* 71 Fed. Reg. 64443 (Nov. 2, 2006).

commercial market in the United States that, among other commodities, trades natural gas contracts.

ICE has several wholly-owned subsidiaries that operate regulated futures exchanges—ICE Futures US, ICE Futures Canada, and ICE Futures Europe. Each subsidiary has its own management and an independent board of directors. Each exchange is overseen by the regulatory authority of the country in which the exchange is physically located. The regulatory authority oversees the exchange and the subsidiary that operates the exchange, but not the parent corporation, ICE.

ICE Futures Europe operates an exchange in London and, on it, trades European crude oil (Brent crude oil from the North Sea), European heating oil, European natural gas, and other European contracts as well as a financially-settled U.S. crude oil futures contract (based on the price of West Texas Intermediate crude oil contracts traded in New York), U.S. gasoline, and U.S. home heating oil contracts. ICE Futures Europe is registered in the United Kingdom, pays U.K. taxes, has U.K. employees, is treated as a U.K. corporation, and is regulated by the U.K. Financial Services Authority.

The CFTC has not deemed the parent corporation ICE to be a U.K. entity; it treats ICE as a U.S. corporation, which it is. ICE Futures Europe, on the other hand, is a U.K. corporation, not because the CFTC has "deemed it to be" a U.K. entity, but by operation of U.K. law. Moreover, under U.K. law, the parent corporation, ICE, is not permitted to direct the activities of its subsidiary, ICE Futures Europe, in operating the London exchange. The CFTC thus treats ICE Futures Europe as a foreign board of trade, because ICE Futures Europe is, in fact, a foreign board of trade.

15. STATEMENT (p. 3): *"[T]he statute should also be amended to forbid an exchange from being deemed an unregulated foreign entity if its trading affiliate or trading infrastructure is in the U.S.; or if it trades a U.S. delivered contract within the U.S. that significantly affects price discovery."*

RESPONSE: The 2006 Policy Statement issued by the CFTC discusses the various criteria for determining when a foreign board of trade should be permitted to operate within the United States and not be subject to full CFTC regulation as a domestic futures exchange. The CFTC invited and considered public comments on all of the criteria urged by Mr. Greenberger. The Policy Statement states that the Commission "decided not to adopt any objective standards establishing a threshold test of U.S. location. Commission staff will continue to assess the legitimacy of any particular applicant to seek relief as a 'foreign' board of trade by considering the totality of factors presented by an applicant. This flexible case-by-case approach will permit staff, during a period of evolving market structure, to consider the unique combination of factual indicators of U.S. presence that may be presented by an applicant for relief."

16. STATEMENT (p. 5): *"[T]he Dubai Mercantile Exchange, in affiliation with NYMEX, a U.S. exchange, has also commenced trading the U.S. delivered WTI contract on U.S. terminals, but is, by virtue of a CFTC no action letter, regulated by the Dubai Financial Service Authority."*

RESPONSE: This statement is incorrect. The Dubai Mercantile Exchange (DME) has not commenced trading crude oil contracts in the United States, although it has announced its intention to seek permission to establish DME trading terminals in the United States to trade this contract. Second, the DME is not considering trading a "U. S. delivered WTI contract," but rather a financially settled derivative contract whose price would be linked to the settlement price of the WTI contract traded on the NYMEX. The Dubai WTI-related contract would not require the physical delivery of any crude oil. Third, the trading of contracts on the DME will be regulated by the Dubai Financial Services Authority, not by virtue of any action or inaction by the CFTC, but rather by the operation of the law of Dubai, the jurisdiction in which the DME is located.

The issue is not whether the DME will regulate trading on an exchange located in its country, but whether the CFTC will be able to exercise oversight of DME contracts traded here in the United States. The CFTC has yet to grant DME permission to use trading terminals in the United States for the trading of its WTI contract and, prior to doing so, may follow the precedent set in the United Kingdom and require DME to provide daily trading data and apply speculative position limits to those contracts comparable to the reporting and trading requirements applicable to WTI-related contracts currently traded in the United States. Legislation has been introduced in the Senate, S. 2995 and S. 3129, that would require the CFTC to follow that course of action for every foreign exchange seeking to trade within the United States.

17. STATEMENT (p. 12): *"S. 2995 . . . opens the door to any foreign exchange operating under an FBOT exemption escaping U.S. regulation for any U.S. delivered commodity. . . ."*

RESPONSE: This statement is incorrect. S. 2995 was introduced by Senators Levin and Feinstein in May. In June, a new provision was added to the bill and it was reintroduced as S. 3129, the Close the London Loophole Act sponsored by Senators Levin, Feinstein, Durbin, Dorgan, and Bingaman. There is nothing in either S. 2995 or S. 3129 that would "open the door" to any foreign board of trade "escaping U.S. regulation." To the contrary, both bills would make it more difficult for the CFTC to grant a no-action letter to a foreign exchange than under current CFTC practice. Both bills would require the CFTC, before granting or continuing permission for a foreign exchange to operate trading terminals within the United States, to make a specific finding that the foreign exchange has comparable transparency requirements and speculative positions limits to those in the United States. S. 3129 goes further and gives the CFTC explicit authority to: (1) prosecute U.S. persons who manipulate or attempt to manipulate the price of a commodity in interstate commerce through trading on a foreign exchange; (2) direct U.S. traders to reduce their positions on a foreign exchange when those positions exceed the applicable position limits or accountability levels; and (3) impose recordkeeping requirements on U.S. traders trading on a foreign board of trade or exchange. Both bills would strengthen U.S. oversight of foreign exchanges operating trading terminals in the United States.

18. STATEMENT (p. 13): *"S. 2995 does not incorporate all of the conditions within the present FBOT no action letter typically issued by CFTC staff."*

RESPONSE: S. 2995 and its successor bill S. 3129 do not limit the conditions that the CFTC may impose upon a foreign exchange in a no-action letter; both bills simply require that certain conditions be met before a foreign exchange is allowed to operate trading terminals within the United States. Nothing in either bill would restrict the conditions the CFTC may impose upon a foreign exchange to those specified in the bill language.

19. STATEMENT (p. 8): *"The Senate Permanent Investigating Subcommittee has now issued two reports, one in June 2006 and one in June 2007, that make a very strong (if not irrefutable case) that trading on ICE has been used to manipulate or excessively speculate in U.S. delivered crude oil and natural gas contracts. The June 2006 report cited economists who then concluded that when a barrel of crude was at $77 in June 2006, $20 to $30 dollars of that cost was due to excessive speculation and/or manipulation on unregulated exchanges."*

RESPONSE: The 2006 and 2007 PSI reports focused on the role of excessive speculation in U.S. commodity markets; neither report contained any findings on whether traders manipulated crude oil or natural gas prices.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. THOMAS R. CARPER TO MICHAEL GREENBERGER

Question 1. Mr. Cooper stated in his testimony that Americans are paying $1,500 more per year on gas due to high costs. Do people in some areas in the country feel the pain of high gas prices more than others? If so, why?

Answer. It is my understanding that those portions of the country that do not have reliable and affordable mass transits are feeling the pains of gas prices higher than in those jurisdictions where American can substitute public for personal automobile transportations. For example, you hear that rural areas have been hit much harder than urban areas that have mass transit infrastructure.

Question 2. In Mr. Soros' testimony, he stated that only a recession is likely to reduce consumption enough to bring down gas prices. This reminded me of several articles I have read recently regarding Americans' increasing use of transit and makes me curious about its impact on demand. Just this morning, it was reported that transit ridership is up by double digit percentages. Transit in the Wilmington area has seen the 6th largest jump of any commuter rail in the nation. However, many transit authorities are having trouble accommodating the increased demand, and most communities have little in the way of comprehensive, reliable transit. My question is: if reliable transit was available in all or most communities, what would the impact on oil prices be? Could this help Americans reduce demand enough to reduce gas prices without a recession?

Answer. Although those of us who have testified that uncontrolled and excessive speculation has placed unnecessary premiums on American energy consumers, we have also emphasized that supply and demand fundamentals play a role in sky-

rocketing crude oil prices. If reliable mass transit were available in all or most communities then that would undoubtedly ease supply/demand concerns and, in turn, reduce crude oil prices. As I understand it, Mr. Soros' testimony concerning a harsh recession, was directed toward the deflating of what he sees as a classic speculative "bubble." It is my view that the need for a recession can be avoided by developing alternative sources of energy and by time-tested regulatory principles that quickly deflates the speculative premiums now being paid by American consumers. In sum, this problem can be fixed short of Americans experiencing the kind of debilitating recession that Mr. Soros described.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. OLYMPIA J. SNOWE TO MICHAEL GREENBERGER

Question 1. Given your history as a former employee of the CFTC, how do you see the FERC, FTC and CFTC working together with this new authority? Should there be a working relationship between these agencies?

Answer. Yes, these agencies should establish and maintain a close real time working relationship in order to maximize their potential for effectively overseeing the entirety of the natural gas and crude oil markets. In the natural gas market, for example, FERC had substantial experience overseeing the physical supply and CFTC had the expertise to understand the futures markets in that commodity. The combination of the Energy Policy Act of 2005 and the Commodity Exchange Act has allowed both agencies to work together in order to monitor the relationship between the futures and physical natural gas markets. By virtue of the Energy Policy Act of 2005, FERC now has jurisdiction over the natural gas futures market to prevent the distortion of the physical markets by the futures markets. Because of the 2005 legislation, the jurisdiction of the two agencies substantially overlaps on the futures side. While some have viewed this as unnecessary, the two agencies working together—placing a premium on protecting natural gas consumers rather than each agencies' individual interests—has maximized the potential for effectively overseeing the natural gas market as whole.

Under the Energy Independence and Security Act of 2007, Congress included a provision expanding the power of the Federal Trade Commission to combat price manipulation with respect to crude oil futures markets in the same way it expanded FERC jurisdiction into the natural gas futures markets in 2005. If the FTC and the CFTC coordinate to drain excessive speculation and other unlawful activities from the crude oil market as a whole, they would allow market fundamentals, rather than excessive speculation, to dictate the crude oil price. Again, the first step, however, is a coordinated investigation into opaque futures markets to determine whether excessive speculation or other malpractices exist. A real time cooperative and coordinated effort in examining the physical and futures crude oil markets is imperative to determine if dysfunction exist and then to remedy them if the investigation determines that the markets are unhinged from supply/demand factors.

Question 1a. Do you believe that the budgets for these agencies are commensurate to the outlined critical task of policing our energy markets?

Answer. I am favor of increasing all three agencies' budgets (CFTC, FERC, and the FTC) to meet their statutory responsibilities to police these energy markets. However, I also believe that in this time of extreme crisis, these agencies have the authority and the ability to organize themselves effectively to meet the objectives Congress has imposed. In my opinion, relatively small interagency or intra-agency task forces with competent and experienced leadership can satisfy all regulatory responsibilities imposed on these agencies with later supplemental funding serving as undergirding for investigative efforts that should begin immediately. In sum, I support reasonable increases in each of these agencies' budgets. I am optimistic that each of these agencies is capable of reaching congressional benchmarks promptly with effective leadership and organization. As a former CFTC regulator, I have seen what small well led investigative teams can do. All three agencies collectively and individually should begin these efforts immediately with Congress ultimately providing additional resources to see these investigations to their conclusions. Moreover, given the number of inter-Executive Branch task forces that have been convened, additional personnel should be assigned by the Executive Branch to these three agencies on a temporary basis while these investigations begin.

Question 2. Could you help explain why there is a reverse correlation on this chart between the rising WTI settlement price and the decreased volume and open interest market share of trading on ICE?

Answer. The chart does not provide enough information to determine ICE's WTI futures trading volume relative to the market's total volume. As I understand it,

ICE trades WTI futures contracts both on under its "ICE Futures Europe" banner, as well as on ICE OTC. Does the chart reflect only ICE Futures Europe or all ICE WTI trading? Without more information regarding the volume of trading in these other markets, I cannot fully assess the importance of the reverse correlation between the settlement price and ICE's trading volume and market share.

In any event, even if the chart reflects all ICE trading, whether on "Futures Europe" and ICE OTC, it reflects about a 7 percent downturn in ICE's share of the market, leaving ICE at 26 percent of the WTI futures market. That percentage would still in excess of the trading outside the direct supervision of the CFTC to lead to a run up in crude oil prices that bear no relationship to market fundamentals. Of course, this is aggravated by the fact that risk laid off by the energy index funds keeps mounting and those positions on NYMEX are not subject to that exchanges speculation limits. We have seen in recent weeks, major announcements from China about their plan to eliminate oil subsidies and the Saudis' promise to increase substantially daily output, yet the price of oil has continued to rise. This strongly suggests that the price of oil has become unhinged from the fundamentals of supply and demand and is being driven by some other market element. Again, the only way in which the true cause of the crude oil spike can be determined is for a full and careful examination of these markets by U.S. regulators looking to all trading taking place on U.S. trading facilities of the U.S. delivered West Texas Intermediate futures contract. That kind of investigation would settle once and for all what is behind the spike that seems to be unresponsive to increased supplies.

Question 3. Do you believe Mr. Master' underlying assumptions are correct about the market place? Are index speculators artificially driving the price of oil up to levels beyond supply and demand? Do you agree with Mr. Masters' prescriptions to the systems failure?

Answer. Mr. Masters has convincingly demonstrated that large financial institutions are "hedging" their off exchange futures transactions on U.S. regulated commodities futures exchanges, are being deemed by NYMEX (a regulated exchange) and the CFTC, as "commercial interests," rather than as the speculators subject to NYMEX speculation limits. By treating large financial institutions in this circumstance in the same manner as traditional physical hedgers,[1] even fully regulated U.S. exchanges are not applying traditional and time tested speculation limits to the transactions engaged in by what are commonly thought of as speculative interests. In sum, Mr. Masters analysis further explains additional and powerful factors that may very well be separating the WTI crude oil markets from economic fundamentals and his evidence needs to be fully evaluated and, if corroborated by the U.S. government, responded to with application of all of the emergency powers afforded the CFTC under Section 8a (9) of the Commodity Exchange Act, including temporary adjustments of margins and speculation limits by that agency and, if necessary, contract moratoria.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. OLYMPIA J. SNOWE TO GERRY RAMM

Question. Two weeks ago before the Homeland Security and Government Affairs Committee, Mr. Michael Masters, Managing Member of Master Capital Management indicated that commodity index trading has risen from $13 billion at the end of 2003 to $260 billion as of March 2008 and indicated that institutional investors are contributing to the rise in prices. Mr. Masters then proceeded to outline three actions that could reverse this trend. These included: (1) Restricting pension funds from using commodities futures markets; (2) Provide transparency in the over-the-counter markets; and (3) Delineate the classification of position in the commercial category of reports to indicate the position of banks as well as the physical hedgers. Do you believe Mr. Masters' underlying assumptions are correct about the market place? Are index speculators artificially driving the price of oil up to levels beyond supply and demand? Do you agree with Mr. Masters prescriptions to the systems failure?

Answer. Yes. Mr. Masters' testimony outlines the need to reform futures markets by reducing the impact of institutional investment on commodity markets. Commodity futures exchanges were predominately created for oil producers and con-

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[1] Gene Epstein, *Commodities: Who's Behind The Boom?,* Barron's 32 (March 31, 2008) ("The speculators, now so bullish, are mainly the index funds. . . . By using the [swaps dealers] as a conduit, the index funds get an exemption from position limits that are normally imposed on any other speculator, including the $1 in every $10 of index-fund money that does not go through the swaps dealers.")

sumers to offset price risk by entering into a futures contract for future delivery. Over the years, PMAA members have seen a disconnect between commodity prices and supply and demand fundamentals. For instance, Colonial Pipeline had 150,000 barrels of surplus heating oil available for auction on May 7. On that same day heating oil futures on the NYMEX settled at another record-high with its June contract closed with a 9.3ct gain at $3.38/gal with New England temperatures averaging in the high 70s. PMAA have lost faith in the ability to hedge for the benefit of their customers.

Over the last few years, pension funds and endowment funds, etc. use commodity markets as a way to diversify their portfolios and as a hedge against inflation. Currently, the institutional investment "buy and hold" strategy has caused an inflated crude oil price because index speculators do not trade based on the underlying supply and demand fundamentals of the individual physical commodities. When institutional investors buy an initial futures contract, that demand drives up the price. As the contract approaches the delivery month, institutional investors roll the expiring contract into the next delivery month while never taking possession of the physical commodity. This "buy and hold" strategy distorts the futures markets price discovery function. For instance, a buy order from a heating fuel dealer locking in a price for future delivery will have the exact same price impact as a buy order from an institutional investor.

I agree with Mr. Masters prescriptions for a commodity futures systems failure. Institutional investors are not traditional speculators who profit when prices go up or down. Institutional investor's "buy and hold" strategy only profit when prices continue to rise which can have serious consequences. Because the speculation bubble might soon burst, pension funds and endowment funds will likely suffer the greatest losses because they are notoriously slow to react to quickly changing market conditions. When the market corrects, hedge funds will quickly reduce holdings and cut their losses.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. OLYMPIA J. SNOWE TO LEE ANN WATSON

Question 1. Ms. Watson, following our hearing regarding the FTC Reauthorization last month, I was deeply concerned about the lack of urgency from the FTC about implementing Title 8, Subtitle B of the Energy Independence and Security Act. At a time when the rise in energy prices has effectively wiped out the economic stimulus checks, we need to move expeditiously with this new authority to ensure that these markets are not being manipulated. Senators Cantwell, Smith, Dorgan, and Inouye sent a letter to the FTC asking that they move forward with a rulemaking by the end of the year. For many consumers, truckers, and businesses the end of the year is simply not good enough. Are there additional steps that the FTC, CFTC or FERC could take right now to ensure that our markets are not being subject to manipulation?

Answer. FERC staff is working diligently to ensure that the electricity and natural gas markets subject to FERC's jurisdiction are well-functioning, including investigating potential violations of the anti-manipulation authority granted by Congress in the Energy Policy Act of 2005 (EPAct 2005) and implemented by FERC in 18 C.F.R. Part 1c. For example, since the passage of EPAct 2005, FERC used its enforcement authority in two market manipulation cases when it issued show cause orders that made preliminary findings of market manipulation and proposed civil penalties totaling $458 million in two investigations involving traders' unlawful actions in natural gas markets.

With respect to oil and petroleum, FERC's jurisdiction is limited. FERC has jurisdiction only over ratemaking of oil pipeline transportation in interstate commerce under the authority of the Interstate Commerce Act and the Department of Energy Organization Act of 1977, 42 U.S.C. § 7101 et seq. FERC has no jurisdiction over, and therefore no authority to investigate, the prices charged for oil, gasoline, diesel, or heating oil, or the markets where those and other oil and petroleum products are traded.

I am not knowledgeable about, and therefore cannot speak to, the steps the FTC and CFTC may be taking to ensure the markets subject to their jurisdiction are well-functioning.

Question 1a. What does FERC's experience with the additional power from the 2005 Energy Bill educate us about moving forward with the FTC's new authority?

Answer. I cannot speak to the FTC's new authority, but FERC's experience with the additional authority provided in the 2005 Energy Bill has been very good. FERC was able to implement its new authority under the anti-manipulation provisions

quickly and smoothly, due in large part, to the fact that Congress directed FERC to exercise its new authority in a manner consistent with section 10(b) of the Securities Exchange Act, as is detailed in my written testimony that I submitted on June 3. Further, the 2005 Energy Bill not only provided FERC with new anti-manipulation authority, but also provided FERC with enhanced penalty authority. FERC has not hesitated to use its new authority to police market manipulation by any entity, as exemplified in FERC's proceeding against Amaranth. The civil penalty authority granted by Congress in EPAct 2005 enhanced FERC's ability to vigorously enforce the wholesale electricity and natural gas markets that it oversees, as demonstrated by multitude of settlements FERC has entered into with electric and natural gas market participants.

Question 1b. Do you believe that there is an opportunity for inter-agency work on this issue and would that require additional statutory language?

Answer. On April 16, 2008, FERC staff met with representatives of the FTC to discuss FERC's experience implementing the anti-manipulation power granted by Congress in EPAct 2005. In that meeting, and in subsequent communications, FERC representatives answered questions FTC staff had about Order No. 670, the FERC Order promulgating the prohibition of market manipulation codified in 18 C.F.R. Part lc.

FERC staff has and continues to provide any and all assistance requested by the FTC. I do not believe there is any need for additional statutory language in this regard.

Question 2. Two weeks ago before the Homeland Security and Government Affairs Committee, Mr. Michael Masters, Managing Member of Master Capital Management indicated that commodity index trading has risen from $13 billion at the end of 2003 to $260 billion as of March 2008 and indicated that institutional investors are contributing to the rise in prices. Mr. Masters then proceeded to outline three actions that could reverse this trend. These included: (1) Restricting pension funds from using commodities futures markets; (2) Provide transparency in the over-the-counter markets; and (3) Delineate the classification of position in the commercial category of reports to indicate the position of banks as well as the physical hedgers. Do you believe Mr. Masters' underlying assumption are correct about the market place? Are index speculators artificially driving the price of oil up to levels beyond supply and demand?

Answer. FERC does not regulate these activities and these questions are beyond the scope of my personal knowledge. Accordingly, I have no comment.

Question 2a. Do you agree with Mr. Masters' prescriptions to the systems failure?

Answer. FERC does not regulate these activities and these questions are beyond the scope of my personal knowledge. Accordingly, I have no comment.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. THOMAS R. CARPER TO DR. MARK COOPER

Question 1. You suggest in your testimony that the tax code be designed to distinguish between long-term productive investment and short-term speculative investment. Can you explain this proposal, exactly now it might work, and the impact it would have on commodities prices?

Answer. Short-term capital gains have been taxed in the past. The principle is simply that a capital gain on an asset held for less than a specified period of time (*e.g.,* 2 years) is subject to a higher capital gains tax rate. I proposed a tax rate that is 33 to 50 percent higher. This proposal is intended to address the long-term problem of the under investment in long-term assets in our economy. It will relieve pressures on the commodity markets by slowing the inflow funds into these markets. I recommended other reforms in prudential regulation of commodity markets such as, position limits, speculation limits, capital requirement, closing of loopholes and exemptions (Enron, Foreign Boards of Trade, and Swaps) that would burst the speculative bubble in oil. At the hearing I suggested that the speculative bubble had added $40 per barrel to the price of oil. Today, (July 12, 2008), the bubble has grown as the price has increased.

Question 2. You suggest in your testimony that Americans are paying $1,500 more per year on gas due to high costs. Do people in some areas in the country feel the pain of high gas prices more than others? If so, why?

Answer. Yes. While the national average is about $1,500 per household, those living in rural areas spend substantially more on gasoline, compared to urban consumers, because they must drive longer distances to accomplish daily activities. The 23 million households living outside urban areas have suffered an average increase of about $1,875; the 95 million households living in urban areas have suffered an average increase of about $1,400.