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LEVIN-COLEMAN REPORT FINDS SPECULATION ADDING TO OIL PRICES: PUT THE COP BACK ON THE BEAT

WASHINGTON – Senators Carl Levin (D-Mich.) and Norm Coleman (R-Minn.), Ranking Minority Member and Chairman of the Senate Permanent Subcommittee on Investigations, today released a Subcommittee staff report finding that market speculation has contributed to rising oil and gasoline prices, and that too many energy trades are occurring without regulatory oversight. The report recommends that Congress enact legislation to close a major loophole in federal oversight of oil and gas traders, slipped into law in 2000 at the behest of Enron and other large energy traders. “It’s time to put the cop back on the beat in our major energy markets,” Levin said. “Millions of Americans are suffering as the prices of oil, gasoline, diesel fuel, natural gas, and other vital energy commodities go through the roof. These record-high energy prices threaten our economic security. At the same time, our government is less and less able to monitor U.S. energy markets to figure out what’s going on and ensure that energy prices reflect supply and demand rather than market manipulation or excessive speculation. More and more trading is being conducted by large oil and gas traders on electronic markets where there is no oversight. It’s time to put

the cop back on the beat in these markets to make sure that ordinary Americans aren't being ripped off." "I am concerned at the prices that hardworking Americans are paying for energy and troubled by the implication that excessive market speculation or manipulation may be a contributing factor," said Coleman. "The question is whether we have allowed this sector to play by the beat of their own drum – going virtually unchecked and unregulated. We need to take a hard look at whether we have enough regulatory tools to prevent fraud and ensure there isn't profiteering by traders at the expense of you and me." In late April of this year, the price of crude oil on the New York Mercantile Exchange (NYMEX) hit a record of \$75.17 per barrel. In mid-May, the average retail price for gasoline reached \$2.99 per gallon, just a few cents short of the record set after Hurricane Katrina shut down oil and gasoline production along the Gulf Coast in September 2005. Although these high prices are often attributed to the forces of supply and demand, the report demonstrates that supplies have been more than adequate to meet demand. Since late 2004, the amount of stored oil in the United States has been increasing. Oil inventories recently reached 347 million barrels – an eight-year high and the largest U.S. inventory since 1998, when oil was \$15 per barrel. Similarly, oil inventories in Organisation for Economic Co-operation and Development (OECD) countries recently reached a 20-year high. As the report explains, the traditional factors of "supply and demand" do not tell the whole story on oil and gas prices. What is new, according to the Levin-Coleman report, is that over the past few years market speculators have poured tens of billions of dollars into the energy commodity markets. For example, the International Monetary Fund reports that over the past three years approximately \$100-\$120 billion has been invested in energy markets worldwide. Over this same period about \$60 billion has been invested in oil futures on the NYMEX. Many analysts believe these speculative investments have significantly raised the price of oil futures. While it is not possible to determine the precise dollar increase in the price of oil attributable to market speculation, some analysts have estimated that speculation has added as much as \$20-\$25 to the price of each barrel of oil, thereby pushing up oil from about \$50 to around \$70 per barrel. As former Federal Reserve Chairman Alan Greenspan recently stated, "with the demand from the investment community, oil prices have moved up sooner than they would have otherwise." At the same time that oil and gas traders have been spending billions of dollars on energy commodities, those traders are increasingly able to trade without any oversight by the Commodity Futures Trading Commission (CFTC). The CFTC is the federal agency charged with preventing fraud, manipulation, and excessive speculation in U.S. commodity markets. Under the Commodity Futures Modernization Act of 2000, large oil and gas traders may trade energy commodities in "over-the-counter" (OTC) electronic markets without any

ongoing oversight by the CFTC. Additionally, oil and gas traders in these markets do not have to file any large trader reports with the CFTC. Large trader reports are the cornerstone of CFTC oversight of commodity markets to detect, prevent, and prosecute manipulation and to analyze the effects of speculation. Traders in these electronic markets are also currently exempt from the limits imposed by the CFTC on speculative trading that are designed to prevent excessive speculation. In addition, due to past regulatory actions by the CFTC, oil and gasoline traders in the United States may now electronically trade U.S. energy commodities on a London futures exchange, called "ICE Futures." ICE (Inter-Continental Exchange) Futures is regulated by the United Kingdom Financial Services Authority, but not the CFTC. As a result, persons within the United States seeking to trade key U.S. energy commodities – U.S. crude oil, gasoline, and heating oil futures – now can avoid all CFTC oversight and reporting requirements simply by routing their trades through the ICE Futures exchange in London instead of the NYMEX in New York. The report recommends that the CFTC's large trader reporting system be extended to require all U.S. traders of energy futures to report large trades to the CFTC, regardless of where the trade takes place – on the NYMEX, on an over-the-counter electronic exchange, or on a foreign exchange. "Right now, there is no U.S. cop on the beat overseeing U.S. energy trades on over-the-counter electronic exchanges or foreign exchanges," said Levin. "Oil and gas traders on those exchanges are trading without any cop looking over their shoulder. Enron has already taught us how energy traders can manipulate prices and walk over consumers if they think no one is looking and they can get away with it." Levin added, "Our report highlights the need for a legislative fix such as S. 2642 which would put the cop back on the beat in the oil and gas markets." "We need to explore legislative ideas to ensure that energy prices reflect the true market forces of supply and demand and guard against speculators driving up prices," Coleman said. "It is becoming increasingly clear that our efforts must be proactive, as the energy futures market is really about whether families will be able to afford to heat their homes and fill up at the pump. As more and more trading occurs on electronic markets without oversight, it's time to determine whether the scale needs to be tipped from the speculator to the regulator." The findings and recommendations of the report are attached. Copies of the report may be picked up from the Subcommittee at 199 Russell Senate Office Building. The report will be available online tomorrow morning, June 27, at 9 a.m. at the Subcommittee's homepage, which can be accessed via <http://www.hsgac.senate.gov/>. FINDINGS AND RECOMMENDATIONS A. Findings 1. Rise in Speculation. Over the past few years speculators have expended tens of billions of dollars in U.S. energy commodity markets. 2. Speculation Has Increased Prices. Speculation has contributed to rising U.S.

energy prices, but gaps in available market data currently impede analysis of the specific amount of speculation, the commodity trades involved, the markets affected, and the extent of price impacts.

3. Price-Inventory Relationship Altered. With respect to crude oil, the influx of speculative dollars appears to have altered the historical relationship between price and inventory, leading the current oil market to be characterized by both large inventories and high prices.
4. Large Trader Reports Essential. CFTC access to daily reports of large trades of energy commodities is essential to its ability to detect and deter price manipulation. The CFTC's ability to detect and deter energy price manipulation is suffering from critical information gaps, because traders on OTC electronic exchanges and the London ICE Futures are currently exempt from CFTC reporting requirements. Large trader reporting is also essential to analyze the effect of speculation on energy prices.
5. ICE Impact on Energy Prices. ICE's filings with the Securities and Exchange Commission and other evidence indicate that its over-the-counter electronic exchange performs a price discovery function – and thereby affects U.S. energy prices – in the cash market for the energy commodities traded on that exchange.

B. Recommendations

1. Eliminate Enron Loophole. Congress should eliminate the Enron loophole that currently limits CFTC oversight of key U.S. energy commodity markets, and put the CFTC back on the beat policing these markets.
2. Require Large Trader Reports. Congress should enact legislation to provide that persons trading energy futures “look-alike” contracts on over-the-counter electronic exchanges are subject to the CFTC's large trader reporting requirements.
3. Monitor U.S. Energy Trades on Foreign Exchanges. Congress should enact legislation to ensure that U.S. persons trading U.S. energy commodities on foreign exchanges are subject to the CFTC's large trader reporting requirements.
4. Increase U.S.-U.K. Cooperation. The CFTC should work with the United Kingdom Financial Services Authority to ensure it has information about all large trades in U.S. energy commodities on the ICE Futures exchange in London.
5. Make ICE Determination. The CFTC should immediately conduct the hearing required by its regulations to examine the price discovery function of the ICE OTC electronic exchange and the need for ICE to publish daily trading data as required by the Commodity Exchange Act.

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