Senate Democratic Policy Committee Hearing

"Lessons from Enron:
An Oversight Hearing on Gas Prices and Energy Trading"

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Mister Chairman and members of the committee, thank you for inviting me to speak with you on an issue affecting consumers across the country.

Last fall, local natural gas companies began informing the public that their winter gas bills would reach record high prices. As the Illinois attorney general, I serve as the chief consumer protection advocate in Illinois with specific statutory authority to represent ratepayers in public utility matters.

In response to warnings from the natural gas companies, we initiated an investigation of the predicted price spike within Illinois and I reached out to other Midwestern attorneys general. Last fall, the attorneys general of Iowa, Missouri, and Wisconsin joined Illinois in launching a multi-state investigation to examine the reasons for the expected dramatic rise in natural gas prices. Over the next several months, we met with representatives of local utility companies and natural gas producers.

We learned that:

1) There is an almost complete lack of transparency in the unregulated financial markets for natural gas; and

2) Contrary to common media reports, skyrocketing natural gas prices over the past several years cannot simply be explained by traditional supply and demand factors because demand has been relatively flat.

I'm here today to elaborate on our finding concerning the financial markets for natural gas.

Our investigation revealed that financial markets for natural gas are far less regulated than the markets for many other less-essential commodities. Natural gas trading takes place in unregulated, over-the-counter (OTC) markets and lightly regulated exchanges like the New York mercantile exchange (NYMEX). The reality is that approximately 80% of natural gas trading is done on the unregulated over-the-counter markets. These over-the-counter markets are a major factor in setting the price of natural gas. And even in markets where there is light regulation, the rules are inadequate to protect the public.

There are few regulations for registration or reporting by brokers and, to make matters worse, information regarding who is holding what positions is almost non-existent or unobtainable. Indices in the natural gas market are based largely on self-reported trades.

Indeed, from a law-enforcement perspective, it is almost impossible to ascertain whether any antitrust, securities or consumer laws are being broken. We simply do not have access to the information typically used to conduct those sorts of investigations. Without this information, we are unable to answer the most basic questions, such as who bought what and when?

This is a particularly serious problem for consumers because natural gas is a unique commodity. It is a necessity for most Americans and the upward spiral of gas prices has an enormous impact on our economy and on consumers' checkbooks.

For instance, one Illinois school district spent about $300,000 for heating in 2002. By 2005, the gas bill had jumped to $400,000. In 2006, it's approaching $700,000. In other words, the cost has more than doubled in four years. A retired factory worker in Chicago barely makes ends meet on $1,100 per month. In December 2005, his gas bill balance was $430—double what it was at the same time in 2004. And yet, despite the fact that skyrocketing natural gas prices represent such an urgent problem for American consumers, current law permits the price for natural gas to be left to an almost entirely unregulated market.

It is outrageous that we fail to regulate markets for natural gas – a commodity that has a huge impact on household budgets and is vital to our economy – less than we regulate markets for soy beans and pork bellies. The decision to allow over-the-counter markets in natural gas to go entirely unregulated was an error that is reversible. Regulators must be able to see transactions across all markets in order to assess whether traders are attempting to game markets. Large traders must register and report their transactions if the public is to be protected from market abuse.

The recommendations offered in the Midwest AGS' report focus on the improvement of market oversight by the Commodity Futures Trading Commission (CFTC) and are similar to those proposed by Senator Feinstein, Snowe, Levin, Cantwell, Mikulski, Harkin, and Boxer in the amendment to the CFTC reauthorization. I applaud Senator Feinstein's efforts and hope that the legislation reverses the unfortunate decision to allow the over-the-counter markets in natural gas to go entirely unregulated.

Finally, although our investigation focused on natural gas prices, I want to call the committee's attention to an April 29, 2006 article in the *New York Times,* headlined "Trading Frenzy Adds to Jump in Price of Oil." The article reported that some analysts believe that hyper-trading in these markets may be adding 10 to 20 percent to the market price of oil. It outlined three critical factors that appear to be driving oil prices up: the increasing volumes of trading, increasing volatility and increasing risk in the market. Sound familiar?

Both the natural gas and oil/gasoline markets need careful oversight. Increasing the transparency in these markets is crucial to establishing effective oversight and confidence that the markets are functioning properly. Of course, reform of financial market oversight will not solve the entire problem in our nation's energy markets. However, it is an indispensable step to protecting the public.

Thank you for your attention to these critical issues and thank you for allowing me to share our perspectives with you today.