Senate Democratic Policy Committee Hearing

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

Monday, May 8, 2006
1:30 - 3:30 p.m.
138 Dirksen Senate Office Building

Transcript

DORGAN: I'm going to begin the hearing this afternoon. I'm Senator Byron Dorgan. I'm chairman of the Democratic Policy Committee. I'm joined by Senator Feinstein from California, and we will be joined momentarily by other colleagues as well.

As I have said at previous policy committee hearings, the policy committee in the United States Senate, both the Democratic and Republican policy committees, formed in the late 1940s, are actually empowered to hold hearings. In the law, it describes witnesses and the circumstances of the policy committee work.

We have decided some years ago that we would begin to hold a series of oversight hearings to raise issues and questions that we feel are not being adequately addressed in the regular committee structure, and so the policy committee has held many hearings on many different subjects.

Today, we hold a hearing on the issue of energy trading and the possibility of market manipulation driving up energy prices.

In the year 2002, I was chairman of the subcommittee in the Commerce Committee, and I chaired a series of hearings on the subject of the collapse of the Enron Corporation.

Those hearings demonstrated that Enron and other energy firms, at that point, were engaging in a massive market rigging scheme. The manipulation strategies had surprising and interesting names, like "Get Shorty," "Death Star," and "Fat Boy," and we went through all of the mechanics by which people inside that corporation used a ruse to bilk people out of money.

The strategies were very complex in some cases, but had a clear purpose: to artificially choke off energy supply and to raise prices for the benefit that particular corporation: Enron. It was a culture of corruption then that resulted in the fleecing literally of millions of consumers on the West Coast to the tune of billions and billions of dollars.

Ken Lay, who is now on trial for charges of fraud and conspiracy, was the CEO of the Enron Corporation. He took great umbrage when I said that Enron had a "culture of corruption." When Mr. Lay came before my subcommittee, he was sworn in and he took the Fifth Amendment when asked questions, and he refused to answer any questions about his company's activities. But the truth nonetheless emerged, as his company's own documents revealed a good number of price-fixing schemes.

For example, according to Enron memoranda, the company had "Death Star," a scheme to create the appearance of congestion on California's power grid, in order to force the state's energy managers to pay Enron to "relieve" the congestion. It was a con game, pure and simple. Enron lawyers, discussing one such maneuver, said, "Enron gets paid for moving energy to relieve congestion, even without actually moving any energy or relieving any congestion."

The mounting criminal and civil charges against Enron officials, which initially focused on just accounting schemes, also included energy price-fixing. Former Enron traders Jeffrey Richter and Timothy Belden plead guilty to fraud and making false statements to the FBI. In his plea agreement, Mr. Richter confessed that he and others at Enron "agreed to devise and implement fraudulent schemes."

On March 13 of that year, the Commodities Futures Trading Commission charged another former vice president of Enron with manipulating natural gas prices. Enron ended up paying a fine of $35 million for market manipulation.

The fact is, this corruption operated right under the nose of federal regulators for years and had far too many apologists here in this town.

This hearing is not about Enron. But I want to, as we went through this process, the Senator from California, I believe, was on the energy committee with me at that point in time. I remember raising these questions with FERC and other federal agencies. She raised them repeatedly.

Energy Secretary Spencer Abraham dismissed the claims of price conspiracies as a "myth." Vice President Cheney decried "politicians who want to go out and blame somebody and allege that there is some kind of conspiracy." *Washington Post* columnist Charles Krauthammer suggested that only "silly" Californians "think that the rolling blackouts are a conspiracy by the power companies to raise rates." In fact, Krauthammer said, "politicians are thundering, fingers are wagging, and complicated theories are being hatched" – while the problem is simply that "demand is up and supply is down."

We, of course, have heard no apologies from Mr. Krauthammer. Nor would we expect to.

In the *New York Times*, columnist William Safire warned against "populist interference" with the energy market's "self correction."

Well, we've been through all of this. This hearing is not about Enron, as I've said.

Those who loudly dismissed the allegations of conspiracy, with equal vigor should have stepped forward and admitted they were wrong. They have not. So, we again face skyrocketing energy prices. Different conditions, different times. Consumers are now paying over $3 a gallon at the gas pump. Major oil companies, larger because of blockbuster mergers, have more muscle power in the market place, in my judgment. The OPEC ministers sit in a closed room around a table, talking about how much they intend to supply, how much they intend to produce, and therefore affect supply in price. And finally, the futures market has become an orgy of speculation.

So, because of those three issues, I don't believe there is a free market these days. People talk about the market place. I don't think the market place is working at all. Question is, have we learned anything from the Enron debate and the Enron debacle?

When you ask CEOs energy companies about this, they shake their heads. I watched one this morning appear on one of the morning shows about 7:30. He said, "Well, everything is just fine. It's just supply and demand." Of course, everything being just fine means that his company is showing record profits. The American people have this unbelievable pain trying to figure out on the farm how they are going to get the money together to buy the next load of fuel. Or driving up to the gas pump for a senior citizen or a new high school student just learning how to drive and getting the license for the first time, trying to figure out, how do you pay for the gas in the tank? How do you afford that?

Many American consumers don't understand the intricacies of futures trading and other related issues. We're going to hear from some experts today, some witnesses, who will shed a light on the forces responsible for the surging energy prices we face today.

Robert McCullough is the head of McCullough Research in Portland, Oregon. He testified before the Senate Energy Committee in 2002 in the aftermath of Enron's collapse.

Michael Greenberger, the head of enforcement at the CFTC during the Clinton Administration, will be testifying.

Lisa Madigan, the attorney general for the state of Illinois. One of four Midwestern attorney generals who commissioned a report in March of this year regarding speculation and natural gas prices.

Eric Christensen is an attorney representing Snohomish County Public Utility District in Washington State. Snohomish PUD released the now infamous "Enron tapes" and is a plaintiff in the ongoing trial against Enron before the Federal Energy Regulatory Commission.

Don Olsen is a representative of Huntsman International, one of the nation's largest chemical companies, and supports increasing transparency in natural gas markets.

Erik Saltmarsh is the Executive Director and Chief Counsel of California Electricity Oversight Board.

And Sean Cota, the co-owner and president of Cota & Cota Oil, a family owned business and member of the Petroleum Marketers Association of America.

I thank the witnesses for appearing and lending their voice and their opinions and their thoughts to some critically important questions facing first the American people and second, policy markers, including the White House and the United States Congress.

I want to say at the start as well, that my colleague, Senator Cantwell from Washington, I mentioned Senator Feinstein from California, and others have been very aggressive on these issues. We all sat through some years ago when we were told that these are just markets, just markets working. Don't worry, be happy. Don't bother. There's no conspiracy. Well, we've watched these things in the past. And we saw the West Coast be fleeced to the tune of over ten billion dollars. And that money's not been returned.

And so I think it's important for the Congress to ask tough questions. Tough, tough questions. And find out what's behind the curtain. What's going on? What's causing this circumstance where you have all the gain on the side of the major oil companies and all the pain on the side of the American consumers? What's happening? And we hope to be able to part the curtain and take apart those issues this afternoon.

I'm scheduled to speak on the floor of the Senate at some point later and at that point I'm going to ask Senator Cantwell to chair this hearing during my absence. Let me again thank Senator Cantwell, Senator Levin, and Senator Feinstein for being with us. Let me ask Senator Cantwell for her statement.

CANTWELL: Thank you, Mr. Chairman. I would defer to my colleagues who arrived before I did.

DORGAN: Senator Feinstein was here earlier. Why don't you proceed with your statement, Senator Feinstein?

FEINSTEIN: I can only stay for the first few minutes…

DORGAN: Why don't you proceed with your statement because Senator Cantwell is going to stay for the entire hearing?

FEINSTEIN: Let me begin then by thanking you for holding this hearing, and by thanking my colleagues here for your care and concern, specifically about the West. The western energy crisis, for those of us in the West, and Senator Cantwell and I have many opportunities to commiserate, was really a wake up call about the extent to which energy traders can impact demand and effectively drive up prices. We faced rolling black outs and sky rocking electricity costs, while companies like Enron, Duke, Williams, AES, and Reliant enjoyed record revenues and profits.

Let me just give you the dynamic in my state, California. The cost of electricity in 1999 was 8 billion dollars. The next year, the cost was 27 billion dollars. In 2001, it was 27 ½ billion dollars, and then it dropped back to 12 billion dollars in 2002. Nothing changed. There was no way demand could go up 400%. As my colleagues and I looking into this matter, we realized there was a loop hole in the Commodities Futures Modernization Act, which was passed by the Congress in 2000. And energies and metals were the only industries left out of any kind of oversight and regulation by the Commodities Futures Trading Corporation.

So, natural gas, electricity, oil, gasoline could be traded over the counter with no federal oversight. Enron's demise didn't sound the death knell for electronic trading of energy commodities. Instead, it allowed for a new enterprise to develop. And that's called the InterContinental Exchange, known commonly as ICE, to take its place as the energy trading platform. ICE is an exempt electronic trading facility. Now this means that the Commodities Futures Trading Commission can't require traders on ICE to keep records or report trades in energy commodities. As a result, the CFTC does not have a whole picture as to what occurs in the energy markets. And the one thing we learned from Enron is that traders are after one thing: there is no sense of consumer loyalty.

Remember: Stick it to Grandma Millie. I will never forget it. To me, it told me volumes about the entire energy trading community. We learned the hard way that is there is no oversight of this market, they are subject to manipulation and yet we haven't fixed that problem.

We are going to hear from some of the witnesses today, natural gas prices have been extremely volatile and oil prices have gone through the roof. In fact, the *New York Times* reported on April 29, and I quote, "Crude oil has become a valuable financial asset, bought and sold in electronic exchanges by traders around the world." No record of the trade, no audit trail, no ability for an oversight agency like the CFTC to look at records and see if these trades are bogus or not.

Trading has also increased outside official exchanges, including swaps, or over-the-counter trades. And that comes on top of the normal trading long conducted by oil companies, commercial brokers, or fund held by investment banks. And it's not just the *New York Times* that's saying this.

Testifying at the Enron trial, the former chief executive of Enron North America and Enron Energy Services, David Delaney, was asked this question, "Is volatility a good thing for a speculative trader?" His response, "Yes."

When asked to explain his answer, he said, "The higher the volatility that you have, the better. The higher the potential profit you can make from an open position you might have in the market place. If the price change is only a couple of cents either way, you can't make a whole lot of money in trading. And if you have, you know, 50, 60 cents, dollar moves in price, you are going to make a lot more money for every position you might have."

Now with gas prices reaching $3 per gallon across the country, and well over $3 in my state, constituents deserve to know why those prices are so high. Looking at figures from the Energy Information Administration, we know that crude oil reserves are higher than average, yet prices have more than doubled over the past five years. High gas prices simply cannot be explained by supply and demand.

In fact, BP's chief executive, Lord Browne, has been quoted as saying, "It is the case that the price of oil has gone up, while nothing has changed physically." So without a complete picture of our energy markets, we don't really know why gas prices are as high as they are. That's why some of us have tried to put some oversight into this electronic trading platform.

Senators Snowe, Levin, Cantwell, Mikulski, Boxer, and I have introduced the Oil and Gas Traders Oversight Act. This bill would require traders on exempt electronic trading facilities to keep records – simple. Keep records of the trade. And report large positions carried by their market participants in energy commodities for five years or longer. Keep a five year record. These are the same requirements that apply to any trader that does business over a standard exchange like NYMEX.

Secondly, it would require that these traders provide such reports to the CFTC or the Justice Department upon request. Again, the same requirements as any standard exchange like the NYMEX would require. It would require persons in the United States who are trading energy commodities that are delivered in the country on foreign futures exchange to keep similar records and report large trades.

These provisions are simple, but they will give the CFTC the means to exercise existing anti-manipulation authority over energy commodities traded in United States exchanges.

Now my colleagues and I have been working on this, Senator Cantwell will remember it well, for five years. We see these trading houses, the electronic platforms, lobby like fury to prevent it from happening. They want to be able to trade in the dark. They want to be able to have wash trades. They want to be able to keep no records. They want to provide no audit trail.

And now we see the result. On the West Coast, we saw it with electricity. We now see it with natural gas. The consumer at the pump sees it with gasoline. It's really time for us to change, and it's time to say, what's sauce for the goose is sauce for the gander.

If standard exchanges can keep records, why should an electronic trading platform not keep those same records? I want to just thank my colleagues who have fought this fight for five years. We're going to fight it again and again and again till we get this job done. Thank you very much, Mr. Chairman.

DORGAN: Senator Feinstein, I thank you very much. Next, we'll hear from Senator Levin.

LEVIN: Thank you very much, Mr. Chairman. I want to thank you for your leadership. I want to thank Senator Feinstein, Senator Cantwell, and others for the bill which has been introduced, which I'm happy to co-sponsor.

As U.S. gasoline prices climb past $3 a gallon, American consumers are being told that there is nothing that can be done. The oil industry says over and over again that gasoline prices are reflecting the laws of supply and demand, and there just isn't enough supply to meet demand.

That information is factually incorrect. Right now, as Senator Feinstein said, crude oil inventories in the United States are at an eight year high. We have a chart over here, which shows that there is more oil in storage, that's the right hand side of the chart---there's more oil in storage than we've had since May of 1998, when crude oil cost $15 a barrel.

Refineries that were shut down by Hurricane Katrina are back on line, so there's enough refinery capacity for this crude oil. Right now, the United States has more than enough oil to meet U.S. demand. The same is true for the rest of the world. The Energy Department statistics show that right now, global crude oil supplies exceed global demand by about 100,000 barrels per day, and there is spare production capacity of 1 to 1 ½ million barrels per day.

So why are current prices and future prices of crude oil and gasoline prices going through the roof here in the United States? There have been many excuses that have been provided by the oil industry. None of them explain the problem.

There is the CEO of BP, said recently, "It is the case that the price of oil has gone up, while the nothing has changed physically."

Now one thing has changed over the past few years, and Senator Dorgan, Senator Feinstein have referred to it, and I know Senator Cantwell will. It was changed dramatically with very little notice, and that is the manner in which commodity markets, which is the place where the price of crude oil, gasoline, home heating oil, natural gas, diesel fuel, and other energy commodities are set. How that commodity market operates, that's what's changed. Until recently, all energy futures trading in the U.S. took place on the New York Mercantile Exchange, which traditionally determined the market price of crude oil, natural gas, and so forth.

But in the 1990s, Enron began to change all that by developing a way for companies to trade energy futures electronically using computer software that operated outside of the regulated energy exchanges markets, and that was, of course, over the counter trading.

Enron collapsed, but the concept of electronic over the counter trading outside of the regulated markets, which Enron pioneered, did not collapse. In fact, it took off.

In 2000, a group of oil companies and financial institutions, including BP, Amoco, Shell, Deutsche Bank, SG Investment, Goldman Sachs, and Dean Witter, founded a company in Atlanta called the InterContinental Exchange or ICE, which specialized in electronic over the counter trading of U.S. energy commodities.

In 2001, ICE expanded its operations by purchasing the leading European exchange for trading European crude oil and heating oil futures—the London-based International Petroleum Exchange. ICE renamed it ICE Futures, and last year converted it into an exchange. It does all its trading electronically.

So today, ICE operates two major electronic markets – ICE Futures in London and an over the counter market in the United States. ICE's over the counter market in the United States has grown so large that it has become a major competitor with NYMEX.

What has also happened obviously is speculation. Financial speculators have begun to pour tens of billions of dollars in the trading oil and natural gas commodities. Oil industries analyst, Phillip Grelegger(?) estimates that since 2004, oil traders alone have poured about sixty billion dollars into the U.S. crude oil futures market. Financial institutions have beefed up their commodity trading departments, creating a host of new ways to trade energy commodities and devoted billions of dollars to this new way of making money. And their oil and gas traders are hauling in record profits.

Many analysts believe that this trading activity has pushed up oil prices $20 to $25 per barrel. That's why we have $70 per barrel oil, instead of $50. As Tim Evans, one industry analyst put it, "What you have on the financial side is a bunch of money being thrown at the energy futures market. It's just pulling in more and more cash. That's the side of the market where we have runaway demand, not on the physical side."

We've got to close the Enron loophole, as my colleagues have said. We've got to restore transparency to these markets, which have been darkened by the loophole which Congress created, and the only way for us to do that is to adopt the bill which Senator Feinstein and others have – I believe there are at least six others on there, including Senators Cantwell, Dorgan, and myself who have cosponsored—that will bring some transparency to this market. It's what's critically needed.

We know there's going to be a battle against it. Those who are speculating in these items are going to want to keep trading in the dark and keep regulators in the dark, but we've got to put some sunshine into this process. It's the only hope we have to end manipulation of the market, which caused so much havoc on the West Coast and which is contributing to the very, very inflated cost of gasoline at the pumps today.

Thank you again, Mr. Chairman.

DORGAN: Senator Levin, thank you very much. Senator Cantwell.

CANTWELL: Thank you, Mr. Chairman, and thank you for holding this policy hearing today, and for my colleagues attending. I just want to thank you, Mr. Chairman, for your leadership on this issue, and for your quick and keen sense.

People talk about the smartest guys in the room. Clearly before the Senate Commerce Committee, when you had an opportunity to question some of the Enron executives, you were to the point in asking them then in 2001 about some of their activities.

Unfortunately, those activities weren't necessarily followed up on right away, and the challenge before us today is to learn the lessons of Enron so that it doesn't apply to other markets going forward.

I want to thank Senator Feinstein for her great understanding of this issue. She mentioned the shared pain that we had gone through as Westerners on the western energy crisis. I'm sure it's not much comfort to Californians, but now that we've finally analyzed and gotten more specific on the data, it's come to life that the Northwest actually ended up paying 65% of the profits made by Enron in 2000 and 2001, and California paid 35% of those profits. Those were all dollars that we wish we hadn't had to pay and I commend you for your diligence in sticking with the transparency that we need at the Commodities Future Trade Commission as it relates to the online platform that we've been discussing here today.

Now I just want to point out, because we've been joined by Senator Reid as well and Senator Lautenberg, I doubt that there's a member on this panel that doesn't believe in supply and demand. We believe in supply and demand.

What we're talking about today is whether markets are functioning properly. And when markets don't function properly, and when you have the level of volatility that we've had, you get to the point where everybody is hurt, not just consumers, but long term investors and those that want to see markets function properly. And it's clear that we do not have the transparency in energy trading platforms today to make that transparency work.

Now I want to say a special thank you to the witnesses from the Pacific Northwest, who are here to testify. Eric Christensen and Robert McCullough, because these gentlemen have been tracking this issue for many years, along with my colleagues here on this committee, and have been trying to document the issue as it has impacted the northwest and the fact that we were devastated to the tune of billions of dollars from markets that in the northwest hurt our economy. It hurt businesses. It hurt individuals. It hurt school districts. Repeatedly over the last several years, we've had to convince people that somehow we were actually hurt by this crisis.

I'll never forget receiving a letter from a young woman, whose mother had just bought their first home. She worked for a very energy intensive company and the little girl wrote to us during the Western energy crisis worried that they were going to lose the first home that they ever had because of this energy issue. And certainly other consumers, in fact, in

Snohomish County, I think in one year, we saw a 40% increase in disconnect rates and people really were hard hit by this issue.

So, we certainly don't want to see the same impacts of what has been felt by the northwest then transferred to other energy markets in the same impacts. The Western Energy Crisis cost us between 35 and 40 billion dollars by estimates, but that increase in volatility that could be impacting natural gas and other markets today is what we're after at today's hearing—is to really understand, to not have this issue fool me once, but don't think that we're going to sit by and let another regulatory agency fail to do its job in the oversight of these markets.

We're going to make sure that we get the legislation that we need to make sure that these markets are transparent. Now I know that my colleagues want to also ask questions as it relates to the impacts on other energy markets. But my colleagues have mentioned wash-trading, that is, buying and selling in a close time frame to inflate volume and revenues. I think that this is an important question for us to address today, and I think that there will be other questions as it relates to energy markets and a lack of transparency, particularly things like just in time inventory and other aspects of the energy trading platform that we will have to investigate. Maybe not today, Mr. Chairman, but in other subsequent hearings. So I thank you for your time and attention to this very important issue.

DORGAN: Senator Cantwell, thank you very much. We have been joined by the Democratic leader, Senator Reid.

REID: I apologize for being late. We had some activities on the Senate Floor that I had to be there for. I won't be able to stay a long time, but I do want you to know that you have my full support. This is a very important hearing, and I hope as a result of this, we can do some legislation in some areas that we need to legislate. We've been denied that opportunity.

DORGAN: Senator Reid, thank you very much. Senator Lautenberg.

LAUTENBERG: Mr. Chairman, thanks so much for arranging this hearing. There's a suspicion across America when President Bush and Vice President Chaney took office that there might be an influence coming from the oil industry which would not be helpful to the American public at large. Now we know that's true. The access that the oil industry has had to help write energy policy, sometimes from within the White House grounds, has been a very painful result for the American people. And my colleagues have articulated their concerns about the fundamental flaw in the way that oil gets to the marketplace and what the prices might be when we talk about this unregulated market place—the trading post.

And it is something that deserves full attention. Gas prices and their increases have been devastating. The prices have doubled since the Bush Administration took over. Since 2001, the average annual cost of filling a tank of gas each week has increased by something over 1800 dollars per family. And that at a time when people are having so much difficulty in paying for lots of things like education and health care, other demanding costs that are necessary for life. And, for some reason or another, there's an exemption of responsibility for the oil companies, who are dealing with a commodity that's…(inaudible)…as we might find for the prices of electric or other subsistence levels.

The Republican leaders in the Senate came up with the idea to give every family 100 bucks. Wow. 100 dollars. The American people know what a silly idea is when they see one. The idea didn't go anywhere. The Republican majority retreated pretty rapidly, and they were embarrassed by the public outcry.

So we have to take a look at how we find solutions that in the interim can be of help. That includes taking a look at whether our energy markets are being unfairly or illegally manipulated to raise the price of oil and gas that gouge the consumers at the pump.

We know that the manipulation occurred several years ago with Enron and the price of electricity. So when the price of gas is spiraling out of control, it is not unreasonable for consumers to believe that the same kind of manipulation is affecting prices at the gas pump.

We know of one specific area where the oil market is definitely being manipulated, and that's the export quotas of OPEC. Many OPEC members, including Saudi Arabia, are members of the World Trade Organization. Under the rules of the WTO, it is illegal for members to set export quotas. But the OPEC countries refuse to obey the rules.

Since last year, I've been calling on President Bush to get tough with the OPEC cartel by taking formal action through the WTO and asking them to drop the membership of the countries that are participating in OPEC. I've written letters. I've introduced legislation, but the President, despite hearing the call, has ignored our plea for action.

In fact, just last week, the Saudi Arabian oil minister came to Washington to meet with Energy Secretary Bodman and it would have been an excellent opportunity to send the Saudis a tough message. Stop your illegal quotas on oil exports. And instead, the Bush Administration continued its policy of coddling the Saudis and OPEC.

Enough's enough. Time to get tough with OPEC. We can break up this cartel that exists for one reason, and that only reason is to drive up oil prices.

My office has produced a report that details exactly how OPEC drives up the price that we pay for gas at the pump. The report is on my website, and I encourage everybody to take a look at it.

Mr. Chairman, I wish that the Senate Energy Committee were holding a hearing of this nature, but the rubber stamp Republican Congress has abandoned its duty to provide a check on the Bush White House.

So, the American people are sick and tired of being abused at the pump. They've indicated their lack of faith in poll after poll after poll. This President and his team cannot manage things on their behalf, and they see it. They're rightly suspicious that there is a conspiracy between the oil industry and the Administration.

I commend you, Mr. Chairman, for bringing up this subject and trying to find us a way out of this mess.

DORGAN: Senator Lautenberg, thank you very much.

I wanted to underscore just one point that Senator Cantwell made, and that is I think all of us here would say that we believe very strongly in the free market system. It is the best allocater of goods and services that I am aware of. I taught economics briefly in college. I say that I've been able to overcome that experience successfully, but I understand that the free market system needs a referee. A third baseman in Major league baseball makes the same income as 1,000 school teachers combined. Judge Judy, according to published reports, makes 100 times more money in a year than the Chief Justice of the Supreme Court. Free market? Well, maybe. Smart? Sensible? Maybe not.

The issues that have been raised by my colleagues are really important because they affect every American in a very significant way. And the witnesses who have joined us today are extraordinarily talented witnesses.

We will begin today with the attorney general from the state of Illinois, Lisa Madigan. Let me thank you very much for being willing to travel to Washington to be willing to testify. Attorney General Madigan, you may proceed.

MADIGAN: Thank Mr. Chairman and members of the committee. I appreciate being invited here today to speak with you about soaring natural gas prices, which pose a serious problem for American consumers and businesses. As the Illinois Attorney General, I serve as the chief consumer protection advocate in our state with specific statutory authority to represent ratepayers in public utility matters.

Last fall when local natural gas companies began informing the public that their winter gas prices would be reaching record highs, we initiated an investigation of the predicted price spike within Illinois. Then we joined with the attorneys general of Iowa, Missouri, and Wisconsin to conduct an in-depth multi-state investigation into the reasons for the expected dramatic rise in natural gas prices. Based on our investigation we reached two conclusions that probably will not surprise this committee.

First we found that there is a direct link between the soaring natural gas prices and the fact that here is an almost complete lack of transparency in the unregulated financial markets for natural gas. Second, 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; they have. In fact, virtually unchanged since ten years ago, and supplies last fall and winter were at an all time high.

I'm here today to elaborate on our finding concerning the financial markets for natural gas. During our investigation we learned that financial markets for natural gas are far less regulated than the markets for many other less-essential commodities. The vast majority of natural gas trading takes place in unregulated, over-the-counter markets and on electronic platforms. The trading on these over-the-counter markets is a major factor in setting the price of natural gas. But there are few regulations for registration or reporting and, to make matters worse, information regarding who is holding what positions is almost non-existent or unobtainable. Indeed, from a law-enforcement perspective, it is almost impossible to ascertain whether any antitrust, securities, or consumer laws are being violated. We simply do not have access to the information typically used to conduct those sorts of investigations. Without this information, as Attorney's General, we are unable to answer the most basic questions, such as who bought what, when, and for how much?

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' household budgets.

In Illinois for instance, one school district reported spending about $300,000 for heating in 2002. By 2005, their 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. Individual consumers face similar problems. In the last year alone the monthly gas bill for a retired factory worker in Chicago living on $1,100 per month has doubled to $430 from $200. 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 artificially inflated by unregulated, unreported trading.

It is simply outrageous that we fail to regulate markets for natural gas, a necessary commodity, less than we regulate markets for soy beans and pork bellies. The decision to allow markets in natural gas to go entirely unregulated is 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 and they are similar to those proposed by Senator Feinstein in the amendment to the CFTC reauthorization. I applaud Senator Feinstein's efforts in this regard.

Finally, although our investigation is focused on natural gas prices, I want to call the committee's attention to the April 29 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 the oil markets may be adding 10 to 20 percent to the market price of oil. So it appears that the prices in the oil markets maybe driven higher by factors similar to those affecting the natural gas markets. The natural gas markets need careful oversight. Increasing the transparency in these markets is crucial to ensuring that American consumers ultimately pay fair reasonable prices for natural gas and for reestablishing confidence that the markets are functioning properly. Of course, reforming financial market oversight will not solve the underlying lack of a coherent federal energy policy. However, it is an indispensable step to protecting the public.

I thank you for your attention to this critical issue and for allowing me to share our perspectives with you today. I'd be happy to answer any questions that you might have.

CANTWELL: Thank you, Attorney General Madigan. We're going to let the rest of the panelists speak, and then we'll take questions from members here. Mr. McCullough?

MCCULLOUGH: Thank you very much for the invitation to appear here today. I'm going to put aside my prepared notes and go directly to the heart of the matter.

Really the theme of the Enron manipulations is summed up well in an Enron lawyer's memo that we discovered in our first proceeding, which concludes, "Moreover, even if the contemplated transaction is illegal under current law, it is highly unlikely that any prosecution would be successful for want to necessary evidence." Five years after the start of the California crisis, we still have very little evidence. We know quite a bit about Enron. The next most implicated company, Reliant, we know relatively little about. We have a fair sense of electricity; we have a lesser sense of natural gas and oil.

The fact of the matter is, there is less reporting in the energy industry than there is on staples with little controversy like corn. In a world in which the central fuels that drive our economy have less information than the cereals we eat for breakfast, something is wrong.

In 2002 members of this committee directed the chairman of FIRC to investigate the impact on forward markets that had occurred when Enron went bankrupt. A few days later FIRC announced the PA 202 investigation. At that point we discovered that everything we had feared was correct. That spot manipulations did drive long term prices, that Enron's share of the market was enormous and they were capable of driving spot markets. We discovered there was not only one but a catalog of market manipulations schemes, from wash trades, to project Stanley, to Death Stars, that existed all across North America.

I don't think most people understand that Enron's manipulations are documented in both Natural Gas and Electricity. From Alberta, all the way to Louisiana; this was not simply an agenda that affected the west coast though it caused the most damage on the west coast in part because they were brought to a halt before they could have their full effects. In 2000, Enron purchased more energy, vastly more, than they needed in California.

This was so important that Jeff Skilling was willing to commit perjury last month in his criminal trial on the issue. He stated, "Well we only bought 100 megawatts of forward power." We know the facts are that they bought over 1000 megawatts for that first part of the summer. After they took advantage of those high prices, in large part caused by their manipulations, they sold energy they did not own, again a vast amount of energy, knowing that they may never be forced to deliver with the imminent bankruptcy coming on.

The all important trader tapes are an astonishing story. If it were not for the efforts of the Snohomish County Public Utility District, whose lawyer is here today, we would never have seen them. I've now listened to the trader tapes for 3 major corporations in a number of different states. The fact of the matter is that there would be no regulation without the tapes. There would be no regulation without the additional documents we found. A large number of the tapes were found by me, on a visit to Houston, I looked in a storeroom; it was full of trader tapes that had not been turned over to the FBI. The CFTC and FIRC simply would not have been able to carry on these investigations without this raw material. They did not have enough data to proceed.

We're talking about oil and natural gas today and the fact of the matter is, those are close substitutes. Oil and natural gas show astonishing market anomalies. Last winter, we saw that the forward price of oil declined while forward price of the natural gas went up. That violates every common sense of economics for close substitutes. We also know that the explanatory power of comparing the forward prices in the two markets did not match at all. That bottom line is CFTC does not have the data to explain it, neither does FIRC, neither do we. It's only going to be a detailed investigation going though the actual transactions that's going to explain these anomalies. Thank you very much.

CHRISTENSEN: I have a short PowerPoint presentation. My name is Eric Christensen. I'm Assistant General Counsel at Snohomish County Public Utility in Washington State. We are a relatively small, consumer-owner utility company. I hope our experience in living through the west coast power crisis will shed some light on the subject of the committee's hearing today.

Next slide please.

This is what happened to prices in the Pacific Northwest during the power crisis of 2000 and 2001. It's as if you woke up one day where gas prices had been two dollars a gallon for a decade, suddenly up to eight dollars a gallon and then shooting 20 to 30 dollars a gallon. And in that spike in 2000, that little green spike, you can't really see it, because the graph isn't tall enough. This is what happened in the December of 2000.

CANTWELL: What is the beginning and end point?

CHRISTENSEN: The time period is the second week of December of 2000…

CANTWELL: No, the price differential.

CHRISTENSEN: Well, it went from about $ 24-25 before the crisis and ended up, we believe, about $3500, although it took us a long time to figure out what the price really was on that day.

So facing those kind of prices of course, next slide please, these quickly work their way down to the consumer level. We were forced to raise our retail rates in Snohomish County by 60%. This caused devastation across the country, unemployment, suffering, consumers living without power, the rate of disconnects increased by 50% between 2000 and 2001, and reached the highest level in almost sixty years.

To give you one concrete example, I talked to a lady who is taking care of her mother who is suffering the onsets of Alzheimer's disease, living in a trailer park, and the first bill her mother received in 2001 was for nearly $750, and this is for a lady who lives on $1400 a month from Social Security.

The demand for assistance for people to pay for their power bills was so overwhelming that the heating assistance office in Snohomish County is running out of money by about March of each year since the crisis began, which is ironic because that's when the highest bills generally hit for the winter heating season.

Next slide please.

We have a pretty good sense now of the cumulative impact on consumers. We know that in Washington state about 43,000 jobs were lost, about $1.3 billion in disposable income was wiped out. Across the west as a whole about 600,000 jobs, and 1.5% of regional domestic product was lost. Between this and aftermath of the terrorist attacks on September 11, tipped our economy went from being one of the most robust in the country to having one of the most in deep recessions.

This was no secret to Enron, this is analysis that was put together by Enron's internal economic analysis department, listing the states that were most susceptible to the California crisis, and of course our state of Washington is at the top of the list.

Next slide please.

How did this come about? You can call it the Enron Gap. The Federal Energy Regulatory Commission initiated a radical experiment called "Market Based Rate Authority," moving away from the traditional utility model where utilities were granted a monopoly and in return got a regulated rate of return based on their demonstrated costs to a model where rates were set by the market. Unfortunately the Market Based Rate Authority was given out based on assumptions that no longer applied in an industry that was rapidly changing; no one was ever turned down as far as we could tell for Market Based Rate Authority; there was a filing requirement but that was basically un-enforced. The 9th circuit called this "regulatory with abdication." At the same time the CFTC was moving out of the markets which allowed Enron to move in which they did with a vengeance.

Next slide please.

So into the Enron Gap. Enron moved into---have adopted standard contracts in the industry that moved electricity to a standard commodity model where it had traditionally be treated as a necessity most like water rather than like a commodity like corn or pork bellies. Unfortunately this was done with the context of virtually no regulation in an industry that's uniquely vulnerable to market abuse because electricity can't be stored. The system must be balanced instantaneously so if you don't have enough power, you're in danger of having a blackout at any given moment. There's no substitute for electricity, loss of electricity is far more expensive than the cost of the commodities itself and buyers like Snohomish PUD don't have the ability to say no.

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The response from FERC was at best inadequate based, I think, on the almost religious devotion to the ideology that de-regulation is better than regulation in any context. And they now concluded that they should have enforced contracts that were now tainted by the market dysfunction. On top of that, the staff was actually pretty good rate engineers under the old model but were inadequately trained to understand how even markets were supposed to work.

They dropped the ball on Enron online which was the Enron electronic trading platform, they really had no idea what was going on there. Next slide please. The result was kind of the opposite of what you would want if you were a consumer. It's a kind of expensive market with a great deal of volatility, exactly the opposite of what you want when you are a consumer, which is reasonably priced electricity at a predictable rate. There are a couple of the quotes that Senator Feinstein alluded to.

Next slide please.

We know that Enron made enormous profits; the testimony in the trial was that they made well over $1 billion in the crisis period.

Next slide please.

This is Delaney, talking about how good volatility is for speculative traders.

Next slide.

This is the convicted head of the Enron power trading operation in the West talking about how good volatility is for power traders. This market produces some perverse behavior, we have a tape where Enron is ordering a plant in Nevada to shut down at the time California is going into blackouts. Can you play the tape please?

[Tape playing][Not Discernable through recording]

To put a cap on it, to deal with that kind of manipulation we need a robust regulatory system which we lack at this time.

CANTWELL: Mr. Christensen, thank you for your testimony. Thank you for your diligence in pursuing this issue. I know that you have been cited in many newspaper articles and news stories as the small guy taking on the big Goliath. Thank you very much for your investigative work in this issue.

CHRISTENSEN: Thank you for your work on this. You've been a real champion for us.

CANTWELL: Mr. Saltmarsh, thank you for being here.

SALTMARSH: Thank you very much Senator Cantwell. Thank you other members. I am honored to be invited to share with you a perspectives about California and the western states energy crisis, about lessons from that crisis, and about where we are today in the United States energy markets. I don't have to tell the members of this distinguished committee that the markets for a number of energy commodities in the United States are critical to the welfare and safety of the citizens of the United States and to the U.S. economy.

I am going to depart somewhat myself, somewhat from the comments that I have prepared, partly because of the excellent comments of those who have come before me, that touched on many of the points I would make. I certainly do not wish to have it seem to the audience here or to the members that there is any competition between California and the northwestern states on who suffered the most. We are all colleagues here, and I think as Senator Feinstein pointed out well, California consumers suffered $32 billion net, net that we attribute to the drought that occurred in the second year of the energy crisis and would have resulted in some higher prices. Once you factor in, we still think there was a net of about $32 billion—excess charges in the spot market, about $12 billion in longer term contracts that Californians have borne. Having said that I have nothing but sympathy for everyone in neighboring states because I have heard anecdote after anecdote about how hard it has been there as well.

I am known primarily in this town for my work on behalf of California in seeking refunds and remedies from California's energy crisis to some extent as counsel for California on some natural gas pipeline manipulation matters. I really don't have any experience directly in the petroleum markets and petroleum industries although I think the lessons from one of these energy markets apply well the questions that you are facing in others. I do find myself an involuntary speculator in gasoline. I'm told my gasoline holding increased last week by about $2 in the tank of my car, but I lost it all on my way back to the airport.

My agency is charged with monitoring and investigating on behalf of the state and its consumers, matters in natural gas and electricity markets to try to detect problems and try to bring them before federal regulators.

In 1998, it was my belief that we could see about 70% of the relevant trading going on in both wholesale electricity and wholesale gas markets and from that portion of the iceberg that we could see, it is my studied opinion that we could probably tell about 90% of what was going on in terms of the dynamics of who and what was setting prices.

Right now and in particular having been asked to look at natural gas markets following the price increase after the Gulf Coast hurricanes, it is my opinion that we can see perhaps 25% of the relevant trading in those markets and my confidence of being able to really tell what is going on there is somewhat lower than 25%. I say that in part because all of my colleagues here have been zealous in their efforts to act as investigators and advocates on behalf of their consumers, and one model that could potentially be followed to get to a ripe and just outcome would be for the injured people and their representatives to come forward and make their case if in fact there was an adequate forum to seek a refund or a remedy after the fact. To the extent we could do that in 2000 and 2001, which of course we have not been able to adequately do after years and years of effort, I think we are less able to do today. I am less able to see what is going on in those markets and have less able to collect relevant information.

During the California energy crisis and indeed before the California energy crisis as we were trying to figure what was going on in markets that looked much more reasonably under control at the time, we were attempting to evaluate those markets from the data that was before us and that data primarily related to physical deliveries, physical production in trades of energy, fairly near real time, whether it was natural gas or electricity.

I am reminded in this hearing of a statement that was made to me prior to the onset of the California energy crisis by a vice-president of Enron at a time in which Enron was still at its most boastful and brash. He was essentially trying to discourage me from my hopes at being able to figure out what was going on. He told me in a statement that I have no idea the truth of today, that at the time Enron was a counterparty to over half a trillion in energy derivatives and that if I had no idea of those positions were in the market place, I couldn't begin to understand people's action in the physical commodity and what was driving prices. Again, I don't trust that the statement that I got from an officer at Enron at the time was an accurate one reflecting their business position but I have taken to heart the notion that if I can only see a little piece of it, and I can't see the financial positions that have been taken around these markets, I really don't know what people are even motivated to do.

One point that I want to make because Enron is so notorious in so many ways that you can't have a hearing of this sort without them figuring prominently is that while its easy and you see many in the industry these days pointing their own fingers at Enron and essentially blaming the dead guy for everything that went wrong, in our investigation of the California energy crisis, Enron was certainly not the only player. Enron is now associated with a number of trading strategies that they in their internal memos gave incredibly creative names to. In almost every one of those strategies, Enron is not the first entity to employ those strategies at some point in the marketplace. Whether they invented it or learned it from somebody else, they became the people that are considered to have owned it. They are not the only practitioners, they are not the inventory.

Even if they had been, Enron was significant in some of the abuses, not so significant in others that have occurred in California. They were very significant in some pivotal positioning, like the existence of Enron online. I firmly believe that if the rules and regulators allow it to happen, that vacuum will be filled and someone else will put themselves in a position where they will be able to do it and they probably will do it if they can do it.

Just to add one quick anecdote so they aren't all about Enron, we heard a very compelling tape about a physical electricity production facility being taken offline for the purpose of exercising market power and driving prices. During the height of the California energy crisis when there was a huge amount of misinformation flying in all directions and various entities attributing what was going on to various factors, some of them benevolent and some of them benign. There were a great number of power plants offline in California that went offline suddenly and reported themselves as broken. In response to that, there was a piece of legislation in California that would give an agency of California authority to go an inspect power plants that were broken and create rules for the maintenance of power plants to try to have them break less in the future. In an effort to convince me how mis-applied the effort in that legislation was, the vice-president for a generation, for a major national energy company who has power plants in California and who is not Enron, was sitting in my office, saying "I hope you don't support this legislative direction to create this needless legislation." Looked me in the eye and said, "You know full well there no maintenance problem in California; there's a payment problem in California. As soon as California agrees to the right price, the power plants go right back on." It is my belief that is the mentality that was pervasive at the time, but it's my belief that is the mentality that will pervade wherever it is allowed to pervade.

I mentioned that we have attempted to look into natural gas prices as they serve California following the Gulf Coast hurricanes. What I will admit to you about that, is using the same techniques to get information that I felt worked fairly well for us five years ago, we weren't able to figure out very much. Right now I certainly do not have access to enough information to reassure the people I work for that those markets are working competitively and that fair market dynamics are setting those prices and it's my belief sitting before you that there's no single federal regulator who could come in before you and tell you honestly that they have enough information that would allow them to do that, one way or the another.

I will try to wrap up here. I know we're short of time. Clearly I have indicated that I would support greater transparency in energy markets and greater recordkeeping and reporting to the relevant regulators. I have spent a number of years in this and my colleagues have presented you with some very interesting and compelling data. I have decided to make my discussion with you very data non-intensive because increasingly it's more compelling to me to back far enough away where I can only try to address things in common sense discussion. I lose all my data points, so many of them have tried to go into my brain. We are still sitting here, debating competing opinions that are out there in the world as to what physically happened in the west and what physically happened in California. I want to suggest that in a great number of other industries, if five or six years after there was some kind of a crisis effecting millions of people, you were unable to have the relevant regulator come before you and present you with firm hard data of exactly what everyone was doing, you would consider it outlandish. You couldn't come in four years after some sort of an unfortunate aviation accident and say well there's no recordkeeping of where the planes were supposed to fly or what maintenance was done or who owned what. I think that the notion that a recordkeeping requirement is excessive in this industry is really a crazy one. There are arguments all the time in the energy industry that regulation will stifle participation in open and free markets. I too am a believer in open and free markets. I simply want to suggest to you that the United States around the world has had a reputation for having well regulated markets, not unregulated markets. Money has flowed in from all over the world for decades and decades because the United States securities and equity industries were seen as well regulated, not unregulated. The Algerian stock exchange is unregulated and it's not where people put their retirement income.

The last thing I will say, and I say this with great caution because I think the notion there is a national security interest in something has been said a little too freely in recent years about too many things. It is my belief in the current state of at least the natural gas and electricity industries, and I might say it about petroleum if I knew it a bit better, that if it was someone's intention not to make a lot of money, but to cause a lot of chaos, it would not take a lot of investment and infrastructure to create a couple of small institutions that were well positioned to create chaos in these U.S. energy markets for at least a couple of weeks. It is rather amazing to me that we don't have more information collected about who these people are and what they are doing simply from the point of view that if there was anyone with a motive other than honest or a dishonest profit motive, that we would have sense of who they were. With that, I thank you very much.

CANTWELL: Thank you Mr. Saltmarsh, and I know my colleague Senator Feinstein has to leave, but in previous attempts to get the transparency that all of you talked about, I remember one of our colleagues on the floor saying that because people didn't understand derivatives, was a good reason not to have regulation and oversight of them, so I appreciate what you're saying about the broad picture and trying to explain this information to people because I think it's important to for people to understand the target of transparency that we're seeking.

I'd like to ask each of—first I'm going to start with Mr. McCullough because we're issuing a report today as well about –I mean, we're here to talk about transparency today in general and about transparency in the energy commodities that lack transparency and thereby have issues of volatility. But your report identifies what you believe are anomalies in oil and natural gas trading, can you elaborate on that?

McCULLOUGH: We currently have a low level of reporting in natural gas and oil. Of the major exchanges, only NYMEX is facing regulation. Now we know from previous abuses that's not enough. When Jojo Nath of Reliant decided to put in place wash trading on Bloomberg, he was able to put it on one side and not the other. No regulator would ever have detected it. On the ICE exchange, we had a broad history of wash trading but no regulator was able to detect that.

CANTWELL: Explain what you mean by wash trading.

McCULLOUGH: My apologies. Wash trading is when you have a very non-economic transaction; one party will sell the same commodity at the same price to another, the second counterparty will sell the exact same commodity at the same price back to the first. Its only role is to create the illusion of a price change or a quantity.

We found in our investigations over the last few years, it was very widespread and it wasn't just widespread through Enron online, it was very widespread throughout the industry. When we were preparing our report we were interested to see if there was any evidence that we had trade data being filed that didn't seem to match the underlying transactions. In other words, a wash trade which might give an idea that some prices were at a certain level, but they didn't seem to match the underlying economic and financial logic.

We could use oil to power cars, but we can also use it to run power stations. We use natural gas to run power stations but if you've taken a bus recently, you know it can be used to power transport. The two commodities should be very closely aligned. Now on the spot level we expect to see deviations if there's a gas pipeline problem or an oil problem, we would expect to see spot prices differ. What we would not expect to see is to see forward prices differ and we would not expect to see the pattern of forward prices differ for a period of months. In the winter of this year what we saw was a very unusual circumstance, the forward price of oil was falling, the forward price of natural gas was rising. Now if a trader believed that there was weather information that would affect his forward positions, he had a better than average copy of Farmers Almanac, and he could predict that February was going to be more expensive, how was it that only natural gas traders at that point appeared to have a better copy of Farmers Almanac? We know that's improbable.

Short term supply disruptions begin to disappear as we move out in the forward market simply because they get repaired. Switches between fuels, power plants decide to go to oil from natural gas because the prices are higher necessarily brings the two markets back into balance. In the winter of this year we saw that the two forward markets not only deviated, but they deviated at an increasing rate. Worse than that, there was no correlation between the two forward prices on the NYMEX between two markets for quite a period. This is the sort of behavior we expect to see when we're seeing wash trading; or we're seeing non-economic data showing up because people are making arbitrary and non-economic transactions. If I was at the CFTC I'd be opening the books to see if I could find a pattern of wash trading, but here's the problem. If the purchase on a wash trade was made on NYMEX, but the corresponding sale was made on ICE, the CFTC would not see it; they only have data on NYMEX. This is exactly what has happened in past wash trading examples. And so the outcome of this is that with only being able to observe half the market is effectively equivalent to being able to observe it not at all. Without CFTC being able to access data on ICE or on the over-the-counter market, we don't know whether that anomaly, which by the way which costs America billions of dollars, is in fact an example of manipulation as we saw in previous years or simply an inexplicable event.

CANTWELL: Now you're talking about oil and natural gas markets over the last several months. You're not talking about the historic Western prices; you're talking about recent data.

MCCULLOUGH: That's correct. Absolutely.

CANTWELL: Attorney General Madigan or anyone else, do you have any comments about your ability to detect wash trading or your ability to get at that information?

MADIGAN: I think all of us have testified here today that we have almost a complete inability to make a determination if there are any violations of securities laws, anti-trust laws, or consumer laws because there is just an utter lack of transparency in markets where the vast majority of trading is taking place for natural gas and that is incredibly ironic and unfortunate that we see—whether it's for corn, soybeans, pork bellies—those markets are regulated; we can tell what's taking place in those markets but for a necessity for natural gas or oil, we don't have a similar ability. What we learned through our investigation and eventual report was there absolutely has to be registration. There has to be regulation. There has to be reporting in order for us to make a determination if laws are being violated.

SALTMARSH: I would second that and say, with respect to my comments, we can see less and tell even less about what's going on now. We can see some reported trades; we can see enough to know that in recent months, those reported trades do not correlate with the traditional fundamentals that you would look to and if the prices were close to those fundamentals, you would think that the market is functioning competitively. There's a deviation from the fundamentals; we see come trading reported. We don't know whether that trading is half of a trade that gets cancelled someplace else and that is in effect a fake price, and if it's a real price why it's at that level.

CHRISTENSEN: I would just add from the perspective of a consumer owned utility with load serving obligations, these price reports are really critical because these are the data we use to make our purchasing decisions. If the data is wrong, we're going to make wrong decisions. The hallmark of the California crisis was we couldn't figure out what prices were doing and why. The sudden jump in prices in May 2000 didn't make any sense because there was no change in supply and demand economics before the crisis to the next week when it started. In that kind of an environment, it's difficult to figure out what's going on and what you should do to properly address with the crisis, if the price deviation is going to last or anything like that.

CANTWELL: Explain what you mean by load serving requirement.

CHRISTENSEN: As with most utilities in the United States that serve customers, we're under a legal obligation to make sure that when a customer shows up and asks to be hooked up, we hook them up and we cover all their demands. That's a legal obligation, so unlike if you're a consumer of gasoline, for example, you can choose to take the bus or walk. We don't have that luxury as an electric utility, so we have to buy, and that's one of the things that makes the electric markets particularly vulnerable to market power.

SALTMARSH: The last point that occurred to me, while I will certainly acknowledge in concept that you can put regulatory burdens on businesses that are erroneous and unproductive, I want to point out that the information we're talking about is information that is normally kept in the ordinary course of business and kept in a very sophisticated way, except for the closets that Mr. McCullough found tapes in. For commercial purposes and potentially for auditing or accounting purposes, or litigation disputes for transactions down the road, companies have to have records of their trading. I don't know the formats in which those are kept necessarily, but this is not necessarily advocating for the collection of information that is not routinely kept within the companies today. It's just not available to regulators or anybody else.

MCCULLOUGH: May I make a short comment? I'd like to point out that Enron's recordkeeping was very good. They had not lost the tapes. They simply failed to turn them over to the FBI.

One issue here that is so critical is the large trader reporting program at the CFTC. When Enron was taking a position so extreme in the summer of 2000 that if it had become public it would have immediately initiated an investigation, it was not observed by anyone, not by Mr. Saltmarsh's group, who are very good, simply because there was no data on that. We have no way to determine whether or not such positions are being taken today.

How did we find out about all these abuses? As appalling as it is, our knowledge is anecdotal. We reviewed the tapes and brought these abuses to the attention of the authorities. Without the review of the tapes, we would not have discovered manipulation of the Bloomberg electronic platform in 2001. We certainly would not have discovered Enron's manipulation of NYMEX in 2001. So without that transparency you would have to be supernatural as regulators to figure out what was going on.

CANTWELL: I want to thank the panelists and for their testimony. We have another panel and we want to make sure that we get to it today. Thank you for your input and for coming to Washington on this important issue. I would like to now call up Mr. Greenberger from the University of Maryland; Don Olson from Huntsman International; and Sean Cota from Cota and Cota Oil.

Good afternoon gentlemen. Mr. Greenberger, we'll start with you.

GREENBERGER: Thank you very much. I too am going to submit my testimony which tries to give you a history of the Commodity Futures Trading Commission has dealt with the issue you are considering today.

I want to say in the first instance, as you know, the Commodity Futures Modernization Act was added under cover of darkness in the middle of the night to an 11,000 page consolidated appropriation bill during a lame duck Congress in December 2000. It was signed into law December 21, 2001. All the trading we're talking about today, the inability to see it, the fact that it's offline, nobody knows what's going on, was illegal on December 20, 2000. On December 21, 2001, it became legal.

The Enron online operation which, by the way, started before the law was passed because they were so confident of its being passed, has been mimicked throughout the electricity scandal---it was a school for scandal. And the school is such today that you're not going to find the tapes that were uncovered in the electricity market, when we talk about other commodity markets. They've learned that you don't tape that, just like Osama Bin Laden has learned not to use cell phones. They've learned not to leave an audit trail behind.

They were so confident after this CFMA was passed, and I'm sure there weren't two Senators who understood what was in that 266 page law. It was written in seven different Wall Street Law firms; there were exemptions on exemptions on exemptions, because they wanted to make sure these trading facilities would not be seen by the public. Every commodity market we look at today is approaching record prices, even the agricultural commodities and this is going to set off not only a problem at the gas pump, but you're going to set off the possibility of inflation.

The futures market is essentially a price discovery mechanism. When you go to buy a house in a community, you don't just let the real-estate broker tell you how much you're going to pay; you want to know what other houses cost. The futures market serves the same process. If you have people who are committing wash trades in houses, buying them for no economic reason and driving prices up, the real-estate broker is going to come to you and say the price is up plus x over what the economic fundamentals of what that house is going to cost. That is exactly what is happening today in the commodity markets, it is exactly what is happening in the oil markets. As the Chairman of British Petroleum just so articulately said, as pointed out by Senator Feinstein, economic fundamentals do not explain this market. What is happening is phony trading is going on in the futures market, and then the oil companies and the gasoline retailers say, oh well that's the price. That's the way we know what the price is. It's been pumped up.

With regard to natural gas, the conservative members of the House supported the same kind of legislation that you and Senator Feinstein have introduced and have made it a part of their Commodity Future Reauthorization Act for natural gas, because their constituencies are not looking at this from free market, non-free market systems. They were in December 2005; they were paying through the teeth for natural gas. December 14, 2005, when the House passed that legislation, was the peak for the natural gas market. On after, it started to sink. Why? Because the traders now understand that what they are doing in those markets may be discovered and they have to be very careful. My bet is that if the Senate was to pass your legislation, than that passage in and of itself would substantially drive down the oil futures market.

Enron online started this, the energy exemption was gotten at their behest, but it's because the electricity manipulation was a school for scandal, everybody wants a piece of this. There are 420-some hedge funds who are thought to be principal traders in this market. Hedge funds are creating a double opaqueness. One, as you know, hedge funds are lightly regulated and they are trading in products that are unregulated. As state officials have told you, you do not know what is going on in these markets.

The final point I want to make is that we keep saying the CFTC is not able to find this out. Unfortunately, as the CFTC as sits here today, they don't want to find this out. The most critical arguments made against looking at this market are by commissioners of the CFTC. And the reason for that is, it is a very small agency. I served there for two years under Chairperson Borne, who tried to bring transparency to those markets, and I'm sure that Senator Cantwell, as you saw when you introduced your legislation in 2002, that the lobbying and the amount of money that goes into arguing against this, and not only arguing against it, but embarrassing the people who are trying to argue against it, is a 24 hour a day, 7 day a week operation. The CFTC sadly but truly does not have the courage to look into this market. It's one thing to pass this legislation; it's another thing to make sure they use this legislation.

Finally I would say the ICE exchange does have an obligation to keep records. It came into existence in a no action letter given to the International Petroleum Exchange which was a foreign entity trading foreign products, in 1999. In 2001, it was bought by ICE, and now that trading was shifted to Atlanta, but they are still operating under that no action letter, and who is their principal regulator? Not the CFTC, but the UK Financial Services Authority, even though it's an Atlanta based institution. The CFTC tomorrow could turn that around. Even under the no action letter, ICE signed the first one for another London exchange, we were careful to reserve the right to get data. The CFTC tomorrow could order ICE to give it all the data it wants. Why doesn't it? Because ICE is really the play thing of big United States investment banks and there is not the courage to take on those banks and do what needs to be done.

I believe we're not only talking about exchanges other than NYMEX. We're talking about a massive over-the-counter market that nobody knows the full extent of and who is in it. ICE is just a player in it, besides NYMEX. The CFMA didn't just de-regulate the over-the-counter market, it de-regulated every market. NYMEX has less regulatory obligations today than it had December 19, 2001. And Congressman Graves, a Republican from Missouri who fought to get the transparency in the natural gas markets and the legislation that passed in the House, cited as one of his examples "the rules of NYMEX have become so out of control that they encourage volatility on that exchange." So this is an area that needs to be looked at from top to bottom, and my own view is, I think it's a long way from saying you're against a free market, to saying that free market has to keep records and make it available at a time of crisis such as we're facing today. Thank you.

CANTWELL: Thank you, Mr. Greenberger, for your testimony. Mr. Olsen?

OLSEN: Thank you Senator. Good afternoon. I thank you for the opportunity to participate today and for really shining a light on this. We're hearing so much about this all being a supply and demand issue. We're a major natural gas consumer and while we do not oppose efforts to increase the deliverable supply of natural gas including by expanding storage capacity, we are convinced unlike most of our colleagues in the chemical industry that the current problems in the natural gas market are not due to the fundamentals of supply and demand. Our production has remained virtually constant, we have near record amounts, if not record amounts, of natural gas in storage yet we continue to have the highest and most volatile natural gas prices in the world. We believe that this market suffers from an illusion of appropriate regulation. Because of the way the market for natural gas futures is setting the prices for natural gas there is a compelling need to reform the regulatory framework for these vital markets.

Now in our industry, we're a global leader and natural gas is a key commodity for us, as it is for thousands of domestic businesses and millions of farmers. We use it as both as a fuel to power our processes and we use its derivatives as feed stocks to make our products. We purchase the fuel monthly; we have to purchase the derivatives virtually every day. Like all other natural gas consumers we depend on the commodities markets and in particular, fair pricing in the commodities markets in order to be competitive both domestically and abroad. High and volatile natural gas prices have forced us to reduce our domestic workforce by more than 1,500 men and women. All of our capital for expansion for the past five years, approximately $1 billion has been allocated overseas where natural gas prices are more stable and lower. Huntsmann occasionally is able to hedge where we can lock in prices that we charge our customers. But locking in natural gas prices without being about to lock in prices for the end use product amounts to speculation, and we're a manufacturer. We don't gamble. We're not speculators. In most cases, we cannot improve our competitive position by hedging our gas purchases. Put simply, severe price volatility makes it virtually impossible for us to establish a budget for our natural gas costs. Natural gas prices, as you've heard over and over today, are based on prices that futures are traded on the NYMEX.

Since the year 2000, as Mr. Greenberger has so eloquently said, concurrent with the passage of the CFMA, price volatility in the NYMEX natural gas futures contracts has increased substantially, by some measures as much as 60%. Prior to the passage of the CFMA the historic price of natural gas was about $2.30 per MMBTU; now it is triple that amount today. It has spiked several times, much higher than that. Moreover the CFMA amendments have permitted the trading of natural gas futures both in over-the-counter markets and on electronic trading facilities that escape much regulatory scrutiny. Even though the CFTC has taken steps to respond to unlawful acts in the natural gas futures trading market, we believe that congress should strengthen the CFTC's authority to address with these issues.

Just four suggestions if I might. Congress should consider broadening the CFTC's authority to enforce the anti-fraud and anti-manipulation provisions of the commodities exchange act against persons conducting transactions in exempt commodities like natural gas in over-the-counter markets. Second, Congress should strengthen position reporting in the natural gas markets. In this regard, S.2642 is a good first step. Third, Congress should increase penalties for fraud and manipulation. And finally, we believe that meaningful and reasonable trading stops would help to remove the volatility in natural gas prices.

Senator, thank you very much for the opportunity to be here today if you have any questions I'd be happy to answer them.

CANTWELL: Thank you Mr. Olsen. I will have questions, but I'll let Mr. Cota finish up this second panel. Mr. Cota?

COTA: Thank you. I'd like to thank the committee for the opportunity to discuss the issues that are affecting all Americans and their ability to pay for energy. Just so you know a little bit about how I'm different from the rest of the mix here, I'm a third generation owner of a family retail business. I'm the folks who actually meet the consumer. We provide and have provided for over 60 years propane gas, heating oil, gasoline, and diesel fuels in the New Hampshire market and I'm currently the president of the New England Fuel Institute, which is a trade association representing 1,000 retail heating oil distributors and about 40% of the nation's heating oil. Additionally, I am currently serving as Northeast President of the Petroleum Marketers Association of America, a nation-wide independent trade association.

I want to disagree with a few things that were said earlier about supply and demand. There are some supply and demand issues that are going on. China does make some kind of a difference. Also, some of our environmental regulations that are currently coming into phase right now, particularly the ultra-low sulfur diesel, which virtually no one is aware of, generally in the public, that's going to be coming up very shortly. I do believe because of the supply constraints and the delivery constraints, it is going to affect the market forces that affect price. That's part of it. That's not the whole plan.

There are some elements that are in the trading arena that do not follow supply and demand, and Americans, particularly retail consumers—some of this demand is inelastic. At a certain point, people still need to heat their homes. If you have a job and your job is 30 miles away, you're still going to need to use gasoline to get to that job.

I've been hedging for my consumer base for over 15 years, directly hedging for the retail consumer. The anomaly that I have with the market is that I am one of the few components of the entire futures contract market where I take delivery of a futures contract. Just so you have some idea what the trading volumes are, the annual heating oil industry is about 8 billion gallons of heating oil sold in the United States per year. On NYMEX, which is just one of the mechanisms for trading in heating oil, every three days, that amount is traded. And that goes to a lot of the points that were made earlier about the volumes of trades and where these trades are going. What is the purpose for the volume of these trades.

Another thing that is unique about the commodities market, which a lot of people don't know, is its relationship to the stock market. The stock market requires 50% margin requirement on any stock investments on the NYSE after the crash of 1929. The commodity industry generally has a 5-10% margin requirement. Even on that basis, anyone who has a ton of cash, like Mr. Soros or any large derivative fund, for that same dollar they can make about ten times what the investment would have been in the regular equities exchange. And I think that's important to understand.

We as an industry applaud Senator Feinstein's, Snowe's, Levin's, and Cantwell's bill for having more disclosure in the markets. You cannot have a market that is a well functioning free market unless it has visibility and transparency in that market, and I agree with everyone's comments on how opaque it has become. Even within the one trading group that actually does track the data, the NYMEX, and gives that data to the CFTC, there is a lot more data that they track that is given to the CFTC. I do believe that the CFTC has more authorization, if they do get reauthorized to investigate a lot of the trades.

Another one of the commodities anomalies in the trading business is that there is groupings in heating oil and most of the contracts that are sold between small speculators, large speculators, and the industry. The industry includes investment banking folks if they have some storage the lease from some oil company. They've got a huge ability to direct and drive the market, there's no distinction made. The other two that were talked about, ICE and the derivatives market for the investment banking community, nobody collects any of that data, and that to me is just a good reason for markets to be manipulated and nobody will ever be able to prove that it was. I think that this is in the national interest that we have the CFTC have fuller recording requirements. I think this serves everyone in the country dramatically, whether it's a Democrat or a Republican, and we encourage you to pursue this as much as you can, and I'll answer any questions.

CANTWELL: Thank you Mr. Cota, and again thank you to the panelists for your testimony and for your perspective on this issue and the challenge that it means to your particular aspects—to the industries that you're involved with.

Mr. Greenberger, if I could start with you. You mentioned a couple of things. First, the larger over-the-counter transactions and the historical nature and broad exemption given to over-the counter…maybe if you could spend a few minutes talking about those contracts and the effect of those contracts versus the NYMEX as far as oversight and transparency. And then if you could also comment on your…you mentioned you though the NYMEX was missing some rules that it also could have in place, if I'm not misunderstanding your statement, if you could comment on that.

GREENBERGER: You understood me correctly. The CFMA against the recommendation of Alan Greenspan, Arthur Levitt, Secretary Summers, and then-CFTC Chairman Rainer, deregulated and allowed for energy commodity trading to be done outside of exchanges, by computers, and to be totally, except for having to tell the CFTC that they're doing it, they can just do this trading by themselves. That was originally sponsored by Enron; Enron very badly wanted to legitimize what they were already doing, probably illegally..have their Enron online validated.

When the big investment banks, who were not particularly interested in this, saw what could be done in the California electricity crisis situation, they wanted to get into this trading in the over-the-counter commodity market big time. I said as an example of that is their supposedly over 420 hedge funds involved in this markets who aren't regulated like mutual funds, and are dealing with these transactions which happen over computer and nobody knows what's happening.

It just goes on, so when you heard the tapes about the wash trades earlier, and, as Mr. McCullough said, they just stumbled on that, no federal agency got that information; some of it was voluntarily made available by lawyers for Enron in Portland, but nobody's investigating that. Nobody's looking to see what happened. So that, for all we know, could be happening on a regular basis. We do know it's profitable. Enron made a ton of money on it before the end came. But no one knows. The exemption is in section 2h3 of the CFMA. It creates an exempt commodity and exempt exchanges. It does allow the CFTC to do something about fraud and manipulation. And also, I think a fair reading of that statute says, the CFTC can aggressively, when it has suspicions that something's happening, go in and collect the very kind of information that we want to seek today. But the CFTC---

CANTWELL: But not on over-the-counter…

GREENBERGER: Even over-the-counter, Senator Cantwell, and I'd be happy to walk you through that. They do it for fraud and manipulation, there are record keeping requirements in 2H3, but the CFTC has treated it as if it isn't there. They've taken the position de factor, they've never announced it. When the Enron tapes and memos came out, before that happened, they took the position that they didn't have investigative authority. They had to be shown fraud and manipulation. Finally, much to everyone's surprise, including the CFTC, it was shown by people like Mr. McCullough, and they had to do something, and they investigated. By the way, you talked about the billions and billions that were lost, after the investigation, the CFTC throughout this industry, many institutions collected as much as $300 million; basically it's cost of doing business damages, so I think there's an argument to be made, already they could look into this market but clearly they don't want to. That's why your legislation is so important.

Then when you get rid of the over-the-counter market, and you're looking at the formal exchanges that aren't these backroom, suspender wearing investment bankers aiming for their big bonus at the end of the year. When you're talking about the exchanges, ICE is in business only because if the predecessor company got a no action letter on the basis of it being a foreign entity and that it would be regulated by the Financial Authority Services in the UK that happened in 1991. In 2001 ICE bought IPE. They've moved most of the trading to Atlanta and now call themselves an Atlanta-based company and they are still treated as a foreign company being regulated by the FSA.

Now if that isn't bad enough, the no action letters that granted the old IPE this authority clearly, and I have it in my testimony, says, and I wrote that first one. I knew exactly what we were worried about. We were worried about manipulation on those foreign markets. We reserved the right to collect data. It's right there in the no action letter. The Justice Department reserved the right. We not only that but we made it a condition of every grant of no action approval that there be an agreement between the foreign regulator and the CFTC that we could go to the foreign regulator to get that data, so there were two different ways to do it. But today, it's as if that never happened. They continue to treat an Atlanta-based company, with substantial ownership in U.S. banks as if it's in London and not in Atlanta. It's just amazing.

Then you come to NYMEX, the so-called good exchange, that's carefully regulated. In the CFMA, they completely change the way in these exchanges were regulated. They said to the exchanges, put simply, and I emphasize simply, you do what you want to do, and if we think it's bad, we'll intervene, but we have to show by substantial evidence what you're doing wrong is bad. They completely reverse the regulatory system of having to get approval before you do things, and in that name, these exchanges have loosened their own rules and regulations.

Just like on the NYSE when a stock goes way up or a stock goes way down, what happens? Dramatically, they stop trading in the stock. It's a cooling off period. The Chicago exchanges still have what are called limit requirements; if the commodity shoots up or the commodity shoots down, they stop trading, and there's a cooling off period. What Mr. Huntsmann is complaining about, the limits are so low and so high, that's it's almost as if its not there, and then when they are put into effect, they are put into effect for five minutes. So the so-called good exchange that's regulated, that we're all pointing to as an example, has had its regulation so related that it too, Congressman Graves from Missouri, who led the fight in the House, said the natural gas markets are being manipulated on the NYMEX. This needs to be looked at from top to bottom, not just for the natural gas because the oil things are going through the roof—and by the way ICE, on top of becoming essentially the United States entity, treating itself as if its based in London, with the approval of the CFTC introduced United States commodity contracts in January and suddenly NYMEX got upset because they're now a direct competitor. They've taken 25% of NYMEX's West Texas Crude market, the critical contract. So these markets are going crazy.

CANTWELL: Why don't you have the Chicago Mercantile Exchange and NYMEX and others raising concerns? Here they are in a market operating with a great deal of transparency…

GREENBERGER: NYMEX is complaining about ICE. Amazingly enough, the CFTC isn't doing anything about it. Being a CFTC alumni I can tell you what's happening; Chairman Newsome of the CFTC is now the President of NYMEX, and I'm not saying he's violates any rules, but obviously he's a very bright, well respected man. He wants parity with ICE, he's saying that they should be treated like the United States Exchange. Nothing has happened. Why? Because in the power politics of commodities business, the investment banks—the Goldman Sachs, the Morgan Stanleys, the Citibanks, the J.P. Morgan Chase—run ICE. The way business get done at the CFTC is, who has the power? Usually it's the traders versus the consumers, and the consumers have no power at the CFTC. Here it's a little exchange, or fairly little exchange, versus the powers that be in the American financial community, and in that calculus, ICE is going to get away with murder. Simply put, that's what's happening.

Tomorrow the CFTC could cancel the no action letter and tell ICE to register as a contract market to be on par with NYMEX. Tomorrow, the CFTC could go to ICE and say we want the following information; as could the Department of Justice. Tomorrow the CFTC could tell ICE you can't trade when you're pretending you're a UK company, you can't trade United States products in competition with NYMEX. So Chairman Newsome, now President Newsome, is trying to do something. Unfortunately in this case, he does not wield the power that the investment banks do.

CANTWELL: Thank you Mr. Greenberger. Mr. Olsen, did you want to comment on that? And also on your comments that you can't hedge anymore in natural gas. Obviously one of the tools that many industries across the country have used to try to get out of the way of higher costs is to hedge, to buy in future prices for that product. But you're saying now, you don't even have that option as it relates to the market, so if you could elaborate on that.

OLSEN: Well, the way that our industry works is that we have such a varied product portfolio that unless we are able to lock in prices for our finished goods, it makes no sense for us to try to lock in the price for our fuel and feed stocks; that's gambling. Maybe one of our competitors would be able to buy their feed stocks and their fuel at a lower price than we did and we lose our competitive advantage. So some industries might be able to do that Senator. We cannot. I would like to comment that I want to sit here and shout Amen to everything Mr. Greenberger is saying, but this issue of trading stops, I do want to comment on that.

CANTWELL: That was your fourth recommendation.

OLSEN: Yes. We realized that that issue is not politically palatable to a lot of people.

CANTWELL: Explain that so my colleagues will understand.

OLSEN: As Mr. Greenberger said, on the Chicago Mercantile Exchange, beef, for example, can move 1.5% before trading is suspended for that day or for that trading session. There are many who say that those trading limits or those stops are what saved the U.S. beef market during the most recent mad cow scare.

On the other hand, natural gas which is also traded on the futures market, can move $3 per MMBTU before trading is suspended for five minutes. Then it can move another $3, and so fourth. Theoretically the price of natural gas can move $165 per trading session. I think that the problem of the lack of meaningful trading stops was brought home in force in 2004 when an erroneous natural gas inventory report caused the price of gas on the NYMEX to surge 17%, more than $1.25 per MMBTU. It occurred at the very time when most industrial users were locking in their price for the coming month, us included. The Federal Energy Regulatory Commission on December 17 said that problem occurred because a clerk at Dominion Energy sent the wrong information, hit the wrong key on his computer, and that caused the price of natural gas to spike 17%. FERC said that that one mistake cost U.S. consumers between "$200 million and $1 billion."

We find it incredible that regulators are more concerned with protecting the price of a Big Mac than they are the manufacturing sector of the U.S. economy. But that's why we think that meaningful trading limits of some kind are so necessary in natural gas.

COTA: I'd just like to follow up on a few of the comments made by Mr. Greenberger as well. It's revealing to know who owns ICE. I would recommend that the Senate look into that. That's revealing in itself.

A couple of things. I actually do hedge for the consumer, and I'm the anomaly, like I said earlier, that I actually receive physical delivery of contracts that are…between 50 and 70 percent of my sales are like that. But that's very unusual.

You take a look at the total volume of contacts in the markets that actually do disclose the data, it is less than one tenth of one percent. So, these things are being used as financial instruments, not that that's a bad thing. I'm not suggesting that.

But you need to think about how the financial community can affect that. And I'm suggesting that in the current venue of how I think…the Congress needs to act quickly, because there's a current trend of all of the energy that's bought in U.S. dollars worldwide—it's not bought in euros, not bought in rubles—it's bought in U.S. dollars. For these companies that have huge current trade balances with the OPEC countries, their currently investing in U.S. treasuries, primarily. There's now a trend of moving into commodities.

As that occurs, that's going to create inflation and you're going to find that energy prices will then accelerate, in my opinion, as they start to transition out of U.S. treasuries into commodities that they can then, in theory, transfer around the world. So I think time is of the essence.

CANTWELL: And if you could, Mr. Cota, just elaborate. Most of your associations, they're called jobbers**,** is that correct?

COTA: That's correct.

CANTWELL: They are just in the delivery of the physical product, purchasers if you will, or resellers to the individual retail level, is the correct?

COTA: That is correct. They either deal directly to the retail consumer or the next level up.

CANTWELL: So in those dealings, have you had individuals from various parts of the country come to you to bring up this issue about transparency?

COTA: The issues that have come up with regard to gasoline and diesel in particular is that traditionally supply used to be more of a relationship of crude oil to what the local refining capacity was. And that has changed. The heating oil industry has been doing futures trading for a lot longer by a factor of ten compared with the other segments of the industry. The rest of the nation's jobbers are really grasping at why are things occurring. Why do you have 20 cent moves in a certain market in a certain day that are based upon some factor that comes out upon a New York Mercantile Exchange trade agreement. And that's where we're grasping.

You know, I for example, during the hurricane crisis, I do not buy branded gasoline. I buy unbranded gasoline. The difference in that is that my prices change quite often. I had five price changes during that day, where the branded guys didn't go up. At one point, I was selling 40 cents higher than my competitors at a loss of 20 cents a gallon. That is the dramatic things that can happen in market dislocation that are exacerbated by these financial instruments.

CANTWELL: Could you elaborate on that in the sense that we've had some testimony in other committees about questioning whether the industry ever exported the product outside of the country, maybe for a cheaper price and then just to drive up demand. What you're saying is something different—that the futures price that we were just discussing on these two panels is impacting then the day to day price. Is that what you're point is?

COTA: The day to day price. Quite often I will send my trucks out to get loads of fuel. I won't know what I paid until they get back because the price would have changed five times depending on when they picked that up, the price could be as much as five cents a gallon difference.

CANTWELL: Do your members have concerned about what's causing that fluctuation on a day to day basis in the holding of product?

COTA: If you take a look at who are the biggest holders of energy, one would think that the largest ones would be the major oil industries. The largest holders of energy in the heating oil end of the business and gasoline, if you take a look at storage in New York harbor, it's the investment banking community, Morgan Stanley, those folks.

In order to do a trading deal all the way out to the end, you either have to close out your paper contacts before you have to physically deliver it or you have to physically deliver it. Well the folks that control the storage and control the last segment of that trading contract, those are the ones that will make the most money because they can play it out. In a panic like the mad cow disease, if you had a beef shortage that you thought was going to drive the market crazy, the folks that actually controlled all the beef would have a better advantage. If you control the oil because you control all the storage and you control the final delivery point, that makes a significant amount of difference.

That's why I say that the industry – CFTC gets the industry reports of who's buying what sent to the CFTC from the New York Mercantile Exchange, but it considers the industry, Morgan Stanley, and Exxon, equally, there's no distinction, and I'm saying there is a distinction.

CANTWELL: Have you ever—I know that Mr. Greenberger wants to comment on that—have your members ever talked or complained about people holding onto products, to specifically just wait for a higher price? Holding product a day or two just to wait for a higher price?

COTA: It's all speculative. We don't know. Inventories are high. Heating oil inventories in particular are really high right now. But the contango in the market is so extreme, that anybody in the investment community that can actually lease products will make a huge amount of money. Now once they get into that monthly contract where you received that delivery, there's a thing called the basis event. The basis event is when—if you're controlling the last gallons and it's actually delivered into that month and you happen to be an investment banking group, you can withhold money in your harbor or withhold that fuel in New York harbor and wait for the spot price to increase and then sell it into the market. It was rumored back in the heating oil spike of 2000, where we had a warm January the first week and then it became sub-zero for weeks and weeks, the basis which is traditionally at that point was about 4 cents a gallon, over the next month went to a dollar. That's an example where that could occur. Nobody ever proved it. There's no oversight. There's no accounting.

CANTWELL: Thank you, Mr. Greenberger did you want to make a comment?

GREENBERGER: Well I wanted to make a couple of comments. It's interesting to ask whether the retailers are complaining about this. The fact of the matter is, besides the lack of transparency on the futures market as a whole, there's a lack of transparency in the American public of the relationship the futures market holds on the price of commodities. Copper, for example first now, is at an all time high. This is going to drive inflation. This really should be the subject of a congressional investigation where this stuff is brought out into the open on a broad basis. We're being driven into inflation, not just on natural gas, oil, and some of these other things, but on a broad range of commodities because the lack of regulation. The one principle never to forget is the pricing year is driven by the futures market. And that's why people are saying "oh the gasoline retailer, he's gouging me."

We just got a report from the Attorney General, they can't find evidence of gouging from gasoline retailers. They're receiving a price down the line. What is the price based on? It's based on manipulation of the futures market. If you want to drive the price down, and I believe you could in a flash, if either congressional hearings were held, subpoenaing records, or, in a more limited sense, mandating an agency who really isn't happy about it but mandating them to get this information, that in and of itself will drive the price down because these conversations, which aren't taped anymore, are—there's going to be information that comes out of it and it chastens those people into acting in accordance with fundamental economics rather than financial greed.

OLSEN: Senator, if I could, I couldn't agree more. The amount of gas traded on the NYMEX is by orders of magnitude greater than the amount of gas consumed. If you look at a chart, and I have one I'll be happy to share with you and your staff later, but there is a solid red line that shows consumption in the United States has remained basically the same over decades. But the amount of gas traded is by orders of magnitude greater than that. So the price is not being set by the people who produce or who consume the gas. The price is being set by people swapping paper. They set the price, and they also set this supposed demand that is out there. But the demand is not for people like we are who consume the product, the demand is theoretical. It's set by paper traders.

CANTWELL: Well thank you gentleman, thank you for being here. I thank the other panelists for coming to Washington. I think the message is loud and clear. We need more transparency in the system, but you've also given us the important call to why it needs to be done so quickly. Thank you very much. This meeting is adjourned.