STATEMENT OF SENATOR CARL LEVIN
ON
INTRODUCTION OF THE CLOSE THE ENRON LOOPHOLE ACT

September 17, 2007

Mr. President, today I am introducing the Close the Enron Loophole Act to help prevent price manipulation and dampen the excessive speculation that have unfairly increased the cost of energy in the United States.

This legislation is the product of more than four years of work examining U.S. energy commodity markets by the Senate Permanent Subcommittee on Investigations, which I chair. That work has shown that U.S. market prices for crude oil, natural gas, jet fuel, diesel fuel and other energy commodities are more unpredictable and variable than ever before, and too often are imposing huge cost increases on the backs of working American families and businesses. The legislation I am introducing today is essential to help ensure that our energy markets provide prices that reflect the fundamentals of supply and demand for energy instead of prices boosted by manipulation or excessive speculation. It is also essential to close an egregious loophole in the law that was championed by Enron and other large energy traders in the heyday of deregulation and that continues to haunt our energy markets and harm American consumers through inflated and distorted energy prices.

The "Enron loophole" is a provision that was inserted at the last-minute, without opportunity for debate, into commodity legislation that was attached to an omnibus appropriations bill and passed by Congress in late December 2000, in the waning hours of the 106th Congress. This loophole exempted from U.S. government regulation the electronic trading of energy commodities by large traders. The loophole has helped foster the explosive growth of trading on unregulated electronic energy exchanges. It has also rendered U.S. energy markets more vulnerable to price manipulation and excessive speculation with resulting price distortions. This legislation is necessary to close the Enron loophole and reduce our vulnerability to manipulation and excessive speculation by providing for regulation of the electronic trading of energy commodities by large traders.

A stable and affordable supply of energy is vital to the national and economic security of the United States. We need energy to heat and cool our homes and offices, to generate electricity for lighting, manufacturing, and vital services, and to power our transportation sector – automobiles, trucks, boats, and airplanes.

Over 80 percent of our energy comes from fossil fuels—oil, natural gas, and coal. About fifty percent is from oil and natural gas. The U.S. consumes around 20 million barrels of crude oil each day, over half of which is imported. About 90 percent of this oil is refined into products such as gasoline, home heating oil, jet fuel, and diesel fuel.

The crude oil market is the largest commodity market in the world, and hundreds of millions of barrels are traded daily in the various crude oil futures, over-the-counter, and spot markets. The world's leading exchanges for crude oil futures contracts are the New York Mercantile Exchange (NYMEX) and the Intercontinental Exchange, known as ICE Futures in London. Futures contracts for gasoline, heating oil, and diesel fuel are also traded on these exchanges. Presently, regulatory authority over the U.S. crude oil market is split between British and U.S. regulators.

Natural gas heats the majority of American homes, is used to harvest crops, powers 20% of our electrical plants, and plays a critical role in many industries, including manufacturers of fertilizers, paints, medicines, and chemicals. It is one of the cleanest fuels we have, and we produce most of it ourselves with only 15% being imported, primarily from Canada. In 2005 alone, U.S. consumers and businesses spent about $200 billion on natural gas.

Only part of the natural gas futures market is regulated. Natural gas produced in the United States is traded on NYMEX and on an unregulated ICE electronic trading platform located in Georgia. The price of natural gas in both the futures market and in the spot or physical market depends on the prices on both of these U.S. exchanges.

Trading abuses plague existing energy markets. The key federal regulator, the Commodity Futures Trading Commission (CFTC), reports that overall in recent years it has issued several hundred million dollars in fines for trading abuses in the energy markets. Several major enforcement actions are pending.

Since 2001, the Senate Permanent Subcommittee on Investigations has been examining the vulnerability of U.S. energy markets to price manipulation and excessive speculation due to the lack of regulation of electronic energy exchanges under the so-called "Enron loophole." Although the CFTC and Federal Energy Regulatory Commission have brought a number of enforcement cases against energy traders, the CFTC's ability to prevent abuses before they occur is severely hampered by its lack of regulatory authority over key energy markets.

The Subcommittee first documented the weaknesses in the regulation of our energy markets in a 2003 staff report I initiated called, "*U.S. Strategic Petroleum Reserve: Recent Policy Has Increased Costs to Consumers But Not Overall U.S. Energy Security*." The report found that crude oil prices were "affected by trading not only on regulated exchanges like the NYMEX, but also on unregulated 'over-the-counter' (OTC) markets which have become major trading centers for energy contracts and derivatives. The lack of information on prices and large positions in these OTC markets makes it difficult in many instances, if not impossible in practice, to determine whether traders have manipulated crude oil prices."

In June 2006, the Subcommittee issued a staff report entitled, "*The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat.*"

This bipartisan staff report analyzed the extent to which the increasing amount of financial speculation in energy markets had contributed to the steep rise in energy prices over the past few years. The report concluded that "[s]peculation has contributed to rising U.S. energy prices," and endorsed the estimate of various analysts that the influx of speculative investments into crude oil futures accounted for approximately $20 of the then-prevailing crude oil price of approximately $70 per barrel.

The 2006 report recommended that the CFTC be provided with the same authority to regulate and monitor electronic energy exchanges, such as ICE, as it has with respect to the fully regulated futures markets, such as NYMEX, to ensure that excessive speculation in the energy markets did not adversely effect the availability and affordability of vital energy commodities through unwarranted price increases.

In June 2007, the Subcommittee released another report, "*Excessive Speculation in the Natural Gas Market*." Our report found that a single hedge fund named Amaranth dominated the natural gas market during the spring and summer of 2006, and Amaranth's large-scale trading significantly distorted natural gas prices from their fundamental values based on supply and demand.

The report concluded that the current regulatory system was unable to prevent these distortions because much of Amaranth's trading took place on an unregulated electronic market. The report recommended that Congress close the "Enron loophole" that exempted such markets from regulation.

The Subcommittee Report describes how Amaranth used the major unregulated electronic market, ICE, to amass huge positions in natural gas contracts, outside regulatory scrutiny, and beyond any regulatory authority. During the spring and summer of 2006, Amaranth held by far the largest positions of any trader in the natural gas market. According to traders interviewed by the Subcommittee, during this period natural gas prices for the following winter were "clearly out of whack," at "ridiculous levels," and unrelated to supply and demand. At the Subcommittee's hearing in June of this year, natural gas purchasers, such as the American Public Gas Association and the Industrial Energy Consumers of America, explained how these price distortions increased the cost of hedging for natural gas consumers, which ultimately led to increased costs for American industries and households. The Municipal Gas Authority of Georgia calculated that Amaranth's excesses increased the cost of their winter gas purchases by $18 million.

Finally, when Amaranth's positions on the regulated futures market, NYMEX, became so large that NYMEX directed Amaranth to reduce the size of its positions on NYMEX, Amaranth simply switched those positions to ICE, an unregulated market that is beyond the reach of the CFTC. In other words, in response to NYMEX's order, Amaranth did not reduce its size; it merely moved it from a regulated market to an unregulated market.

This regulatory system makes no sense. It is as if a cop on the beat tells a liquor store owner that he must obey the law and stop selling liquor to minors, yet the store owner is allowed to move his store across the street and sell to whomever he wants because the cop has no jurisdiction on the other side of the street and none of the same laws apply. The Amaranth case history shows it is clearly time to put the cop on the beat in all of our energy exchanges.

The Subcommittee held two days of hearings relating to issues covered in its 2007 report. Both of the major energy exchanges, NYMEX and ICE, testified that they would support a change in the law that would eliminate the current exemption from regulation for electronic energy markets, in order to reduce the potential for manipulation and excessive speculation. Consumers and users of natural gas and other energy commodities—the American Public Gas Association, the New England Fuel Institute, the Petroleum Marketers Association of America, and the Industrial Energy Consumers of America—also testified in favor of closing the Enron loophole.

The legislation I am introducing today is intended to end the exemption from regulation that electronic energy trading facilities now have. The bill includes suggestions made by the exchanges, the CFTC, and natural gas users, and I will continue to seek their input as the legislative process moves forward.

Essentially, this bill would restore the CFTC's ability to police all U.S. energy exchanges to prevent price manipulation and excessive speculation from hiking energy prices. In particular, it would restore CFTC oversight of large-trader energy exchanges that were exempted from regulation in the 2000 Commodity Futures Modernization Act by means of the Enron loophole. The bill would require the CFTC to oversee these facilities in the same manner and according to the same standards that currently apply to futures exchanges like NYMEX. Because these energy exchanges currently restrict trading to large traders, however, the bill would not require them to comply with rules applicable to retail trading or trading by brokers on behalf of smaller traders. In all other respects, however, including the rules that create position limits and accountability levels to stop price manipulation and excessive speculation, the bill would apply the same rules to energy exchanges like ICE as currently apply to futures exchanges like NYMEX.

The bill also would require large trades in U.S. energy commodities conducted from within the United States on a foreign board of trade to be reported to the CFTC. This provision is intended to ensure that the CFTC has a more complete view of the positions of U.S. energy traders buying or selling energy commodities for delivery in the United States. This provision could be waived by the CFTC if the CFTC reaches agreement with the foreign board of trade to obtain the same information.

Mr. President, preventing price manipulation and excessive speculation in U.S. energy markets is not an easy undertaking. I welcome good-faith comments on how this bill can be improved. I want to make it clear, however, that in my opinion the Enron loophole has got to be closed. Recent cases have shown us that market abuses and failures did not stop with the fall of Enron. They are still with us. We cannot afford to let the current situation continue, allowing energy traders to use unregulated markets to avoid regulated markets. It's time to put the cop back on the beat in all U.S. energy markets. The stakes for our energy security and for competition in the market place are too high to do otherwise.

I ask unanimous consent to place a copy of the bill, a bill summary, and a section-by-section analysis in the Record following my remarks.