Gas Prices and Excessive Oil Speculation

Presentation
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I. Excessive Speculation is Needlessly Driving Up the Price of Oil and Other Essential Commodities and Increasing Volatility in Commodities Markets[*]

Over the past five years the price of a barrel of West Texas Intermediate ("WTI") crude oil has radically changed: from $65 in June 2007;[1] to a world-record high of $147.17 in mid-July 2008;[2] to a low of $30 in December 2008;[3] to $75 in July 2009; to $110 in April 2011;[4] to $76 in October 2011;[5] and to $106 as of May 1, 2012.[6] Since the beginning of this month, the price of crude oil has dropped $11 and is now at around $95 a barrel—a remarkably fast price decrease.[7] Needless to say, gasoline prices (a key derivative of crude oil) tend to rise and fall accordingly.

There is widespread recognition that a continued and sustained increase in gas prices will undermine the country's fragile economic recovery and raise the specter of a renewed recession with a substantial further increase in unemployment.[8]

The majority of experts have concluded that the extreme volatility in crude oil prices is not completely related to corresponding changes in market fundamentals.[9] A host of prominent

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[*] A brief biography of Professor Greenberger is attached as Appendix B hereto.

[1] *See* U.S. Energy Information Administration, *Petroleum and Other Liquids: Cushing OK WTI Spot Price* (May 4, 2012), *available at* http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RWTC&f=D.

[2] Financial Markets Group Planning Division, *West Texas Intermediate (WTI): Medium Term Trend Reversal?*, ALPHA BANK (July 18, 2008), *available at* http://www.alpha.gr/files/infoanalyses/Commodities_TechVista_20080718.pdf.

[3] U.S. Energy Information Administration, *supra* note 1.

[4] *See* LiveCharts.com, *WTI Crude Oil Price History (April-May 2011)*, *available at* http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php?type_symbol=futures_wi&start=240.

[5] *See* LiveCharts.com, *WTI Crude Oil Price History (October-November 2011)*, *available at* http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php?type_symbol=futures_wi&start=150.

[6] *See* LiveCharts.com, *WTI Crude Oil Price History (March-May 2012)*, *available at* http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php.

[7] *Id.*; *see also* Leopold, Les, *Wall Street's Oil Scam*, SALON (May 4, 2012), *available at* http://www.salon.com/2012/05/04/wall_streets_oil_scam/singleton/ (reporting that although gasoline prices have been falling prices remain "close to their five-year high after climbing steeply for three years").

[8] *See* Leopold, *supra* note 7 (arguing that excessive speculation "kills jobs" by lowering economic demand for consumer goods—Americans are spending more on gas and so have less money to purchase consumer items—and by shutting down refineries on the East Coast that rely on imported Brent crude oil, the price of which is largely dictated by speculators).

[9] *See* Henn, Marcus, *Evidence On the Negative Impact of Commodity Speculation by Academics, Analysts and Public Institutions* (March 28, 2012), *available at* http://www2.weed-online.org/uploads/evidence_on_impact_of_commodity_speculation.pdf (listing nearly one

economic studies from, *inter alia*, Stanford, Princeton, Texas A&M University, and the London School of Economics, as well as analysis by such prominent market observers as Nouriel Roubini from the Stern School of Business at New York University, have concluded that the five year volatility in the price of crude oil is due in no small part to *excessive* speculation (i.e., far too much speculation) by non-commercial institutions in the crude oil derivatives markets.[10] There are well over 50 studies and commentaries to this effect,[11] including a recent report by the St. Louis Federal Reserve that concludes, "speculation accounted for about 15 percent of the measured rise in oil prices from 2004 to mid-2008."[12]

Supply and demand for crude oil (and for food supplies) have, for most of the last five years, remained in equilibrium and there is near unanimous agreement that there is now no shortage in the global supply of oil.[13]

The disconnect between oil prices and supply-demand fundamentals was evidenced in mid-March of this year when, on nearly the same day, the Saudi King promised to increase crude oil production by as much as 25 percent to make up for any shortfalls from a threatened (but never acted upon) Iranian oil boycott[14] and President Obama strongly hinted that the

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hundred studies and commentaries that conclude that excessive speculation is affecting the prices of staple commodities).

[10] *See* Greenberger, Michael, Comment Letter to David Stawick, Secretary of the Commodity Futures Trading Commission, *Position Limits for Derivatives* 8-9 (March 28, 2011), *available at* http://www.michaelgreenberger.com/files/Greenberger_PL_comment_letter-0328.pdf (citing numerous studies and commentaries showing that excessive speculation (and not market fundamentals) is driving up oil prices) [hereinafter Comment Letter].

[11] *Id*.

[12] Fawley, Brett, Luciana Juvenal & Ivan Petrella, *When Oil Prices Jump, Is Speculation To Blame?*, ST. LOUIS FEDERAL RESERVE, *available at* http://www.stlouisfed.org/publications/re/articles/?id=2232.

[13] *See* Cooper, Mark, Consumer Federation of America, *Excessive Speculation and Pain at the Pump The Never-ending Story: Fixing the Long-Term Fundamentals and Addressing the Short-Term Problems Go Hand-in-Hand* (manuscript with author) ("Consumption is down by ten percent (2 million barrels per day). Domestic oil production is rising for the first time in over three decades. In addition, biofuel production is now equal to over ten percent of domestic crude oil production. Combined, the increase in production equals 1.2 million barrels per day, or about 7 percent of consumption. Imports are down to a level not seen since the mid-1990s. The downward trend of imports is greater than at any time since the price spikes of the 1970s. Spare refinery capacity is up."); Blas, Javier, *Oil Futures Spark Debate on $100 Level*, FINANCIAL TIMES (March 28, 2012), *available at* http://www.ft.com/intl/cms/s/0/24b7eb40-7824-11e1-bffc-00144feab49a.html#axzz1ut8sXkeV (reporting that a forward contract for crude oil to be delivered in December 2018 is $30 cheaper than the $125 spot price for crude oil because traders anticipate that supply will continue to outpace demand).

[14] Lowrey, Annie, *Obama Finds Oil in Markets Is Sufficient to Sideline Iran*, N.Y. TIMES (March 30, 2012), *available at* http://www.nytimes.com/2012/03/31/business/global/obama-to-clear-way-to-expand-iranian-oil-sanctions.html?scp=3&sq=president%20obama%20oil%20prices&st=cse; *see also* Daya, Ayesha, *Saudi Arabia Can Raise Output 25% If Needed, Naimi Says*, BLOOMBERG (March 20, 2012),

United States might very well release crude oil from the Strategic Petroleum Reserve,[15] but the price of crude oil went up![16]

The disconnect between crude oil prices and market fundamentals—oil prices rising when supply increases—combined with clear evidence of physical withholding of oil from energy markets,[17] undercuts ongoing attempts to explain high energy prices purely in terms of market fundamentals. For example, Nobel Prize-winning economist Paul Krugman, who originally remained steadfast in his belief that crude oil prices were dictated by market fundamentals, ultimately embraced the argument that excessive speculative activity is driving up the price of oil.[18] As Krugman observed: "Last year I was skeptical about claims that speculation was central to the price rise . . . this time there's no question: speculation has been driving prices up."[19]

Also, when the price of a barrel of crude oil was reaching $110 in April 2011, the CEO of ExxonMobil testified to the Senate Finance Committee that market fundamentals only justified a price of $60 to $70 a barrel and, subsequently, that supply and demand did not justify the

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available at http://www.bloomberg.com/news/2012-03-20/saudi-arabia-can-increase-oil-output-25-if-needed-naimi-says.html; Blas, Javier, *Saudi Arabia Moves to Calm Oil Market*, FINANCIAL TIMES (March 19, 2012), *available at* http://www.ft.com/intl/cms/s/0/49ec22cc-71ea-11e1-8497-00144feab49a.html#axzz1qtDEb7dC; Naimi, Ali, Minister of Petroleum and Mineral Resources in Saudi Arabia, *Saudi Arabia Will Act to Lower Soaring Oil Prices*, FINANCIAL TIMES (March 28, 2012), available at http://www.ft.com/intl/cms/s/0/9e1ccb48-781c-11e1-b237-00144feab49a.html; Robinson, Matthew, *Oil Falls as Saudi Arabia Seeks to Calm Markets*, REUTERS (March 20, 2012), *available at* http://www.reuters.com/article/2012/03/20/us-markets-oil-idUSBRE82B04920120320.

[15] Mably, Richard, *U.S., Britain Set to Agree on Emergency Oil Stocks Release*, REUTERS (March 15, 2012), *available at* http://www.reuters.com/article/2012/03/15/us-oil-reserves-idUSBRE82E0UM20120315.

[16] *See* LiveCharts.com, *WTI Crude Oil Price History (February-March 2012), available at* http://www.livecharts.co.uk/futures_commodities/oil_prices_historical.php?type_symbol=futures_wi&start=30; *see also* Greenberger, Michael, Testimony before the Commodity Futures Trading Commission, *Excessive Speculation: Position Limits and Exemptions*, 6-7 (Aug. 5, 2009), *available at* http://www.michaelgreenberger.com/files/CFTC_AFR_Sign_On_Testimony_August_3.pdf (noting that investment vehicles used by speculators in the oil market are also used in agricultural commodity markets; food prices move in sync with oil prices and price bubbles in agricultural commodities markets have caused starvation in developing countries) [hereinafter Testimony of Michael Greenberger].

[17] *See* Krugman, Paul, *Oil Speculation*, N.Y.TIMES (July 8, 2009), *available at* http://krugman.blogs.nytimes.com/2009/07/08/oil-speculation/?scp=2&sq=speculative%20trading%20in%20oil&st=cse.

[18] *Id.*

[19] *Id.*

high price of oil at that time.[20] By October 2011 the bubble in the oil markets temporarily burst and the price of oil did in fact drop to close to the $60 to $70 price range.[21]

Indeed, President Obama has on at least on four occasions—June 22, 2008 (during his presidential campaign when crude oil was approaching its world-record high of $147 a barrel),[22] April 20, 2011 (when crude oil spiked to $110 a barrel),[23] on March 8, 2012 (when the price of a barrel of crude oil had again spiked, increasing from the October 2011 low of $76[24] to $106),[25] and on April 17, 2012 (as gas prices at the pump approached $4 per gallon)[26]—expressed an abiding concern that the repeated and extreme spikes in crude oil and gasoline prices were due to speculative malpractices by large financial players in the oil market. Also, the President has analogized the present market disruption in crude oil and gasoline prices to the manipulation of the electricity market on the West Coast in 1999 and 2000 by Enron and its market allies.[27]

Most recently, on April 17, 2012, the President proposed a $52 million plan to expand the Commodity Futures Trading Commission's ("CFTC") market manipulation surveillance and enforcement capabilities and increase the civil and criminal penalties for manipulating commodities markets. The President urged further work by the Justice Department's gas price task force.[28] He also observed that U.S. production is up and U.S. consumption is down.[29] In fact, the world's supply of oil was—and continues to be—sufficiently stable that at the end of

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[20] Lenzner, Robert, *ExxonMobil CEO Says Oil Price Should Be $60 To $70 a Barrel*, FORBES (May 14, 201), *available at* http://www.forbes.com/sites/robertlenzner/2011/05/14/exxon-mobil-ceo-says-oil-price-should-be-60-70-a-barrel/.

[21] U.S. Energy Information Administration, *supra* note 1.

[22] Bohan, Caren, *Obama Vows to Crack Down on Oil Speculation*, REUTERS (June 22, 2008), *available at* http://www.reuters.com/article/2008/06/22/us-usa-politics-obama-energy-idUSN2243134220080622.

[23] Mason, Jason, *Obama Blames Speculators for Rising U.S. Fuel Prices*, REUTERS (April 20, 2011), *available at* http://www.reuters.com/article/2011/04/20/us-usa-energy-obama-speculators-idUSTRE73J1NN20110420.

[24] *See* LiveCharts.com, *supra* note 5.

[25] *See* LiveCharts.com, *supra* note 6.

[26] *See* Cooper, Helene, *As Gas Prices Cast Cloud, Obama Calls for Scrutiny on Market*, N.Y.TIMES (April 17, 2012), *available at* http://www.nytimes.com/2012/04/18/us/politics/obama-urges-oil-market-scrutiny-as-gas-prices-cast-cloud.html.

[27] *See* Obama, Barack, President of the United States, *Remarks by the President on Increasing Oversight on Manipulation in Oil Markets*, THE WHITE HOUSE (April 17, 2012), *available at* http://www.whitehouse.gov/the-press-office/2012/04/17/remarks-president-increasing-oversight-manipulation-oil-markets [hereinafter President Obama].

[28] *See id.*; *see also* Cooper, *supra* note 26.

[29] *See* President Obama, *supra* note 27.

March the President found tighter oil sanctions could be imposed on Iran without affecting market fundamentals.[30]

II. President Obama and House and Senate Democrats Have Led Bi-Partisan Efforts to Tamp Down Excessive Speculation in the Crude Oil Market

Congressional Democrats have repeatedly and successfully intervened to highlight and blunt the adverse impact of excessive speculation on the crude oil markets. On June 26, 2008, as oil prices were reaching their world-record high, the House Democratic leadership and the then Chairman of the House Agriculture Committee (Ranking Member Collin Peterson) introduced legislation (H. R. 6377) that passed the House that same day by a bi-partisan vote of 402-19. The bill required the CFTC to act pursuant to its authority under the Commodity Exchange Act of 1936 and declare an "emergency" in the oil market and impose special limits on excessive speculative activity in crude oil futures markets.[31] On March 20, 2012, Senator Sanders (I-Vermont) along with six Democratic Senators revived this legislation in the Senate.[32]

On July 15, 2008, Senate Majority Leader Harry Reid sponsored legislation (S. 3268) that would have imposed tough congressionally driven limits on excessive speculative activity in the crude oil futures markets.[33] On July 25, 2008, that bill received 51 votes in favor with 93 Senators present, a majority of the Senate, but not enough to invoke cloture.[34] Despite the bill's defeat, certain Republican Senators voted for cloture and others indicated that they might support the legislation in the future.

On September 28, 2008, then Chairman Peterson again brought to the House floor a bill (H.R. 6604) that would impose tough speculative position limits. The bill passed the House 283-133.[35] Also, on July 31, 2008, Senators Wyden (D-Oregon) and Grassley (R-Iowa) circulated a widely publicized discussion draft bill that would have taxed profits from passive speculative

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[30] Jackson, David, *Obama to Proceed With Iran Oil Sanctions*, USA TODAY (March 30, 2012), *available at* http://content.usatoday.com/communities/theoval/post/2012/03/ap-obama-to-proceed-with-iran-oil-sanctions/1#.T3pbozEgef4.

[31] Wisconsin AgConnection, *House Passes Legislation Requiring CFTC to Curb Oil Market Speculation* (June 27, 2008), *available at* http://www.wisconsinagconnection.com/story-national.php?Id=1516&yr=2008.

[32] Restuccia, Andrew, *Sander's Bill Would Force CFTC's Hand in Effort to Lower Gas Prices*, THE HILL (March 21, 2012), *available at* http://thehill.com/blogs/e2-wire/e2-wire/217325-sen-sanders-bill-would-force-cftcs-hand-in-effort-to-lower-gas-prices.

[33] ThomasNet, *ATA Applauds Senator Reid and Other Sponsors of S. 3268* (July 21, 2008), *available at* http://news.thomasnet.com/companystory/ATA-applauds-Senator-Reid-and-other-sponsors-of-S-3268-547049.

[34] Govtrack.us, *On the Cloture Motion (Motion to Invoke Cloture on S. 3268)* (July 25, 2008) *available at* http://www.govtrack.us/congress/votes/110-2008/s184.

[35] Press Release, House Committee on Agriculture, *House of Representatives Approves Bill to Strengthen Oversight of Futures Markets* (Sept. 18, 2008), *available at* http://agriculture.house.gov/press/PRArticle.aspx?NewsID=375.

crude oil futures as ordinary income, thereby hugely cutting into the passive gains by institutions betting on the upward direction of crude oil prices[36]

The combination of all of these Congressional efforts led speculators to fear that Congress would take immediate action to limit speculation in commodities markets and so speculators abandoned these markets in droves. The mass exodus of passive betters from the crude oil market precipitated a radical drop in the price of a barrel of crude oil: the price dropped from its July 2008 world-record high of $147 a barrel to $30 a barrel by December of that year.

In the winter of 2009 when financial institutions realized that Congress would not pass legislation stopping excessive speculation into law, the price of oil once again spiked. Gas prices rose 54 days in a row in the spring of 2009 and by July 2009 the price of a barrel of crude oil reached $75.[37] During this period of high oil and gas prices, the legislation that later became the Dodd-Frank Act began making its way through Congress. President Obama and Democratic leaders made clear that the legislation aimed to impose tough new limits on excessive speculation in commodity derivatives markets and to strengthen the hand of the CFTC by allowing the agency to more easily bring market manipulation cases. Indeed, by the time Dodd-Frank was signed into law crude oil prices had stabilized for almost 18 months—prices fluctuated between $75 and $85 a barrel.

III. Crude Oil and Gasoline Prices Continue to Spike Unnecessarily as Implementation of Dodd-Frank Falters at the CFTC

In January 2011, the CFTC proposed its position limits rule under Dodd-Frank to curb excessive speculation in commodities markets. However, the agency's effort to dramatically limit excessive speculation in commodity markets was met with fierce financial services' opposition.[38] Three of the five CFTC commissioners expressed strong reservations about setting tough limits on excessive speculation. This highly publicized reluctance by 3 of the 5 CFTC commissioners to impose rigorous position limits to curb excessive speculation as Dodd-Frank had intended unleashed the price of crude oil from the $75-$85 price range that it had been trading at since the summer of 2009 and caused the price of a barrel of oil to soon reach approximately $110.

On April 21, 2011, as crude oil was approaching $110, President Obama stated that the price spike in oil was not a result of market fundamentals (which as usual were in equilibrium), but the result of crude oil market manipulation by non-commercial speculators. That same day,

[36] Press Release, Sen. Ron Wyden, *Wyden-Grassley Staff Proposes Level Playing Field for Oil Trade* (July 31, 2008), *available at* http://wyden.senate.gov/newsroom/press/release/?id=681fc35e-e834-4b2d-b7dd-8b1e0e0828b1.

[37] *See* Testimony of Michael Greenberger, *supra* note 16, at 4.

[38] Rampton, Roberta & Sarah Lynch, *CFTC Advances Position Plan, More Hurdles Ahead*, REUTERS (Jan. 13, 2011), *available at* http://www.reuters.com/article/2011/01/13/financial-regulation-limits-idUSN1328349420110113.

he convened a Department of Justice-led inter-agency task force to investigate manipulation in the crude oil market. As a result of the threatened prosecutions for market manipulation, the price of crude oil was, by October 2011, back down to around $75—a price that, according to statements made by the CEO of ExxonMobil in April 2011, accurately reflected market fundamentals.

On October 19, 2011, however, the CFTC issued its final position limit rule by a mere 3-2 vote with Commissioner Dunn voting in favor of the rule but stating on the record that he thought the rule would do more harm than good.[39] The difficulty of obtaining a third vote in support of the final rule meant that the final position limits were exceedingly high and, consequently, the final rule sent a fresh signal to speculative financial forces that they need not fear Dodd-Frank.[40] Again, crude oil prices spiked.

The signal that Dodd-Frank will not curb excessive speculation in staple commodities markets was reinforced on December 2, 2011, when Wall Street trade associations challenged the CFTC's final position limits rule in court.[41] On February 27, 2012, the district court heard Wall Street's motion to enjoin the final rule on an interlocutory basis and strongly indicated that the rule would be stayed.

Unsurprisingly, Wall Street's success in weakening and delaying the implementation of the CFTC's positions limits rule has further encouraged excessive speculation in oil markets. The price of a barrel of crude oil rose from $76 shortly before the final CFTC rule was announced on October 19, 2011,[42] to $108 on February 27, 2012, when the district court strongly indicated that the rule would be stayed.[43]

IV. Congress and the Executive Branch Must Take Specific and Prompt Steps to Permanently End the Economic Pain Caused by Excessive Speculation in Commodities Staple Markets

As things now stand, three factors are clear.

First, Dodd-Frank's attempt to have the CFTC convert the statute's clear intent to limit substantially excessive speculation in commodity staples futures markets has been stymied by

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[39] *See* Loder, Asjylyn & Silla Brush, *CFTC Votes 3-2 to Approve Limits on Commodity Speculation*, BLOOMBERG (Oct. 18, 2011), *available at* http://www.businessweek.com/news/2011-10-18/cftc-votes-3-2-to-approve-limits-on-commodity-speculation.html; Scheid, Brian, *A Position Limits Rule No One Likes, Partisan Fighting, and a Song*, PLATTS (Oct. 20, 2011), *available at* http://www.platts.com/weblog/oilblog/2011/10/20/a_position_limi.html.

[40] *See* Finextra, *ISDA and SIFMA File Suit Against CFTC Over Position Limits Rule* (Dec. 5, 2011), *available at* http://www.finextra.com/News/Announcement.aspx?pressreleaseid=42271.

[41] *Id.*

[42] *See supra* note 5.

[43] *See supra* note 16.

the 3 CFTC commissioners' hostility to that approach in dealing with the CFTC final rule. If rigorous position limits are not defeated by fierce and overwhelming lobbying by Wall Street before the CFTC—lobbying that has removed the possibility of a third vote in support of a final position limits rule that would fully implement the statute—position limits will very likely be defeated by the courts at Wall Street's behest.

Second, the President's inter-agency task force has the potential to have a significant ameliorating affect on inflated crude oil prices. After the President convened the investigative inter-agency task force in April 2011, the price of a barrel of crude oil dropped from $110 to $76 (in October 2011). The President was prescient to reconvene that task force in March 2012 because the United States was facing yet another crude oil price bubble, a bubble that continues to threaten our economic recovery. Even the mere threat of criminal sanctions would cause speculators to pull back from these markets as they did after the task force was first convened in April 2011.

Without effective position limits on excessive speculation, the only option for immediate relief from rising gas prices is a tough investigation into the manipulation of crude oil markets (as Federal Energy Regulatory Commission has done in natural gas markets)[44] led by the Department of Justice. History has shown repeatedly that even a simple, but clear, announcement by federal prosecutors of a serious investigative program will have an immediate ameliorative effect on commodities prices that are alleged to have been manipulated. That prosecutorial road now appears the best path to take in order to bring relatively quick relief to the American public and to end rising gas prices, as these prices constitute a major threat to the United States's economic recovery.

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[44] In 2005 the pricing crisis in natural gas led the Republican controlled Congress to pass the Energy Policy Act of 2005. *See* Energy Policy Act, Pub. L. No. 109–58, 119 Stat. 594 (2005), *available at* http://www.gpo.gov/fdsys/pkg/PLAW-109publ58/pdf/PLAW-109publ58.pdf. The Act gave the Federal Energy Regulatory Commission ("FERC") co-extensive jurisdiction with the CFTC to stop manipulation in natural gas futures markets. *Id*. Since the passage of the Act, FERC has made stopping market fraud and manipulation "an enforcement priority."[44] Federal Energy Regulatory Commission, *Prohibition of Energy Market Manipulation* (April 21, 2011), *available at* http://www.ferc.gov/enforcement/market-manipulation.asp. The agency has passed regulations that ensure market transparency[44] and sought considerable fines from traders who allegedly manipulated natural gas prices.[44] *See* DiSavino, Scott & Jonathan Leff, *Energy Regulators In New Push to Quash Manipulation*, REUTERS (April 12, 2012), available at http://mobile.reuters.com/article/topNews/idUSBRE83B06Z20120412; Clearly Gottlieb, *FERC's New Focus on Transparency and Protecting Against Manipulation of Natural Gas Markets* 1 (Jan. 17, 2008), *available at* http://www.cgsh.com/files/News/c30a1328-e321-4d45-a060-5d6a0bf6c3c6/Presentation/NewsAttachment/2c55bc4e-18c3-4e6e-a3db-6061618857c8/10-2008%20Natural%20Gas%20Alert%2020080117.pdf; Morris, John, *FERC Changes Its Approach in Two Price Manipulation Cases*, ECONOMISTS INC. (Dec. 2009), *available at* http://www.ei.com/vieweconink.php?id=238.

In fact, the recent media scrutiny of Chesapeake Energy—"a powerhouse in the vast U.S. [energy] market"[45]—and its CEO Aubrey McClendon suggests that efforts to restore transparency to commodity trading may, in and of themselves, decrease the price of crude oil. Reuters reported that McClendon had managed a hedge fund that traded in oil and natural gas futures for four years while he was chairman and CEO of Chesapeake and directed the company's own oil and natural gas trades as well as its energy production.[46] This revelation is by itself a red flag for possible market manipulation[47] (e.g. raising the possibility that Chesapeake and McClendon's hedge fund executed classic manipulative and highly illegal trades between each other)[48] and, in and of itself, proves the ongoing need for rigorous government oversight of commodities markets in general and the crude oil markets in particular. In the week after Reuters released its Chesapeake/McClendon report on May 2, 2012, crude oil prices dropped by $8 a barrel.[49]

Third, the process of having Congress legislate broadly while allowing regulatory agencies to implement statutes with specificity appears to be flawed in the area of futures market reform. Those with large financial resources are overwhelming the regulatory process and have unending funds for lawsuits that challenge the CFTC's actions.

Accordingly, Congress should immediately and on an emergency basis enact legislation that bans the use of the two most damaging investment vehicles for speculation in commodity staples derivatives markets: commodity index swaps and exchange traded funds that are premised on synthetic bets on commodity futures price directions.[50]

Both of these investment vehicles allow wealthy speculators to bet passively on the upward direction of a synthetic "basket" of energy and food commodities that is heavily weighted toward crude oil. Persons who take and place these bets do not own any commodities. In this sense, these bets are like bets on a horse race. With regard to commodity index swaps, you can only bet that the price of the basket of commodities will go up. The

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[45] Schneyer, Joshua, Jeanine Prezioso & David Sheppard, *The CEO's Secret Hedge Fund*, REUTERS 1 (May 2, 2012), *available at* http://graphics.thomsonreuters.com/12/05/ChesapeakeMcClendon.pdf.
[46] *Id*.
[47] *Id*.
[48] Driver, Anna & Brian Grow, *Special Report: Chesapeake CEO Took $1.1 Billion in Shrouded Personal Loans*, REUTERS (April 18, 2012), *available at* http://www.reuters.com/article/2012/05/02/us-chesapeake-mcclendon-hedge-idUSBRE8410GG20120502.
[49] *See* LiveCharts.com, *supra* note 6 (indicating that on May 2, 2012, the price of a barrel of crude oil was $105 and on May 8 the price was $97).
[50] See Comment Letter, *supra* note 10, at 9-10, 15 (explaining the deleterious effect of commodity index swaps and synthetic exchange traded funds for speculation); *see also* Greenberger, Michael, *Commodity Swap Position Limit Rule May Help Return Price-Risk Management*, BLOOMBERG BRIEF 7 (Oct. 28, 2011), *available at* http://www.michaelgreenberger.com/files/Final_Draft_Sent_Nov15.pdf; *see* Testimony of Michael Greenberger, *supra* note 16, at 12-13, 16.

betting on the upward price direction and the hedging of those bets in the real commercial-oriented futures market by big banks and other large financial institutions sends continuous false "demand" signals to the markets, causing commodity prices—despite the supply/demand equilibrium—to rise and spot prices to follow suit.

In this respect, H.R. 5186, the Halt Index Trading of Energy Commodities Act[51] ("HITEC"), introduced by Representative Ed Markey on April 27, 2012, and co-sponsored by Representatives Barney Frank and Rosa DeLauro, represents a bold and important first step toward ending excessive speculation in commodities markets. The bill would prevent commodity index funds that trade in crude oil, natural gas, or derivatives thereof, from engaging in transactions with investors who are not bona fide hedgers.[52] Importantly, HITEC identifies commodity index funds as the main cause of speculative activity in staple commodities markets[53] and asserts that speculative activity has "added nearly $1.00 to the per gallon price of gasoline."[54] The bill's impact on speculative activity already appears to have been significant: oil prices dropped from $105 to $98 a barrel in the week after the legislation was introduced[55] and are now at its lowest point since the beginning of 2012.[56] This decline mimics the drop from a world record high of $147 per barrel of crude oil in July 2008 to $30 per barrel in December 2008 in the wake of strong legislative efforts to curb excessive speculation during the fall of 2008 that were mentioned above.

In addition to causing unnecessary spikes in the price of commodity staples, commodity index funds and exchange-traded funds have proven to be bad investments. As one financial analyst explained: "The next time someone tries to sell you a commodities fund based on the Goldman Sachs Commodities Index, smile and say, 'Sorry, but I'm from Earth, and you're from planet *I Love Lucy*. Let's revisit this discussion in an alternate universe.'"[57]

A comprehensive legislative ban on commodity index swaps and exchange traded funds that are premised on synthetic bets on commodity futures price directions (which now consist of hundreds of billions of dollars in passive betting) would not prevent investors from having paths to engage in speculation in energy markets. In fact, persons who wish to do price

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[51] Halt Index Trading of Energy Commodities Act of 2012, H.R. 5186, 112th Cong. (2012).
[52] Natural Resources Committee (Democrats), *Markey, Frank, Delauro Go After Wall Street Oil Investment Products*, Press Release (April 30, 2012), *available at* http://democrats.naturalresources.house.gov/press-release/markey-frank-delauro-go-after-wall-street-oil-investment-products.
[53] Halt Index Trading of Energy Commodities Act, *supra* note 51 ("Almost all of this increase in speculation has been caused by a surge in trading commodity index funds.").
[54] *Id.*
[55] *See* LiveCharts.com, *supra* note 6.
[56] Khan, Chris, *Oil Price Drops to Lowest Point of* 2012, ASSOCIATED PRESS (May 7, 2012), *available at* http://hosted.ap.org/dynamic/stories/O/OIL_PRICES?SITE=AP&SECTION=HOME&TEMPLATE=DEFAULT.
[57] Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, *Excessive Speculation in the Wheat Market* (June 24, 2009) at 102.

directional bets will have other less deleterious investment avenues to pursue. They can buy or short stocks in companies that produce the commodities. They can buy the actual commodities. Or, they can buy long or short contracts in the futures markets. Of course, these alternative and traditional avenues of investment require financial sophistication—they do not comport with the ease of walking up to the "commodity staples betting window" and placing a bet with a big Wall Street bank.

Thus, I heartily endorse a strict legislative ban on passive investment vehicles that trade in crude oil and other staple commodities and that require the "casinos" to offset their bets on the direction of staple commodities by buying long in the corresponding futures markets, thereby creating paper contracts calling for the making or taking of delivery of commodities that far exceed the world inventory of those products.

Further, betting synthetically on the upward direction of commodity staple prices does not put money into energy or agricultural production. Rather, such betting puts money in the hands of the "casino." Today's commodity derivatives markets are overrun with speculation. A smooth functioning commodity staple futures market that adheres to supply and demand fundamentals normally comprises of 70 percent commercial and 30 percent speculative transactions. Today's futures markets are, however, 80 percent speculative and 20 percent commercial.[58] Having these commercial hedging markets being driven by four fifths of those who do not care about the price consumers pay for commodities is the very meaning of "excessive" speculation.

Indeed, energy commodities futures markets are so volatile that (as the 20% commercial participation figure suggests) many commercial businesses are abandoning hedging because futures markets are completely unpredictable.[59] One need only look at the drop in crude oil prices from $147 to $30 in less than six months in 2008 to know that commercial hedging is not for the faint of heart. When businesses abandon commercial price hedging consumer prices will inevitably and unnecessarily increase.

Again, Dodd-Frank did not ban speculation. As was true of the New Deal Congress that passed the Commodity Exchange Act of 1936, Dodd-Frank merely bans "*excessive* speculation."[60] In other words, Dodd-Frank bans speculation that exceeds what the commercial users of these markets need to obtain market liquidity.[61]

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[58] *See* Sanders, Bernie, Senator from Vermont, Letter to Chairman Gensler, and Commissioners Chilton, Wetjen, Sommers, and O'Malia by (March 4, 2012), *available at* http://www.sanders.senate.gov/imo/media/doc/CFTCPositionLimitsLetter.pdf.
[59] Bowley, Graham & William Neuman, *Companies Hedge Bets at a Cost to Consumers*, N.Y. TIMES (May 5, 2011), *available at* http://www.nytimes.com/2011/05/06/business/economy/06commodities.html?_r=2&ref=grahambowley.
[60] *See* Comment Letter, *supra* note 10, at 5.
[61] *Id*.

As I mentioned in my March 28, 2011, comment letter to the CFTC, banning excessive speculation is a "no lose" proposition.[62] All that such a ban would do is stop gambling in commodities markets—gambling that does not add to market liquidity (because it is "excessive") or to the production of the underlying commodity.

Even if one has doubts about the effectiveness of such a ban, no harm can come to the economy by stopping *excessive* speculation on commodity prices. The ban will close casinos—nothing more. And, if the experts are to be believed (those who have produced over 50 academic studies and commentaries on this point), a ban on excessive speculation would cause commodity prices to drop to the point where they would be dictated entirely by supply and demand market fundamentals.

As House Democrats know well, one of the major constraints to effective CFTC enforcement in commodities futures markets is the extent to which the CFTC is understaffed due to Congress's refusal (over House Democratic opposition) to provide adequate agency funding. The CFTC, which only has about 700 employees (and so is extremely small relative to other federal agencies) has performed heroically in implementing Dodd-Frank. It has an unprecedented agenda: Dodd-Frank requires the CFTC to implement well over 50 agency rules, almost all of which call for careful study of what was a previously unregulated and highly complex $300 trillion notional value derivatives market. Many analysts and scholars have established that the failure to regulate the opaque derivatives market prior to Dodd-Frank caused the American taxpayer to bail out banks around the world at a cost of several trillion dollars. Additionally, the CFTC must now defend its final rules against an onslaught of Wall Street litigation.

Again, President Obama's budget proposals (which House Democrats largely support) would properly staff the CFTC; however, resistance to the President's budget proposals in the House as a whole has caused the CFTC to be so under staffed that such efforts amount to a *de facto* repeal of Dodd-Frank. President Obama's proposed $52 million plan to end manipulation in energy futures markets would allow the CFTC to better police the crude oil market and help ensure that speculators do not continue to distort oil prices.

If the American public wants lower commodity staple prices, for what is a relatively small amount of money in comparison, for example, to the bank bailouts, the public must have a cop on this beat. In the long term, the CFTC needs to increase staff from 700 to 1100 and requires an additional $100 million to achieve this goal. One hundred million dollars to save trillions of dollars in future bailouts and to lower commodity prices is a good deal.

In the short term, the strength of the President's convening an inter-agency task force to look at speculative manipulation of gas prices by large financial institutions combines the relatively larger investigative resources of the Department of Justice with the market expertise of the under-resourced CFTC. Again, that strategy should be fully supported by Congress.

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[62] *Id*. at 3.

Appendix A

Selected Works: Speculation and Manipulation in Commodities Futures Markets

1. Comment Letter by Better Markets to David Stawick, Secretary of the Commodity Futures Trading Commission, *Position Limits for Derivatives* (March 28, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=34010&SearchText=better%20markets (arguing that stringent position limits would combat excessive speculation in commodities markets and reduce the price of commodities).
2. Comment Letter by Michael Greenberger to David Stawick, Secretary of the Commodity Futures Trading Commission, *Position Limits for Derivatives* (March 28, 2011), *available at* http://www.michaelgreenberger.com/files/Greenberger_PL_comment_letter-0328.pdf (arguing that rigorous position limits would combat excessive speculation in commodities markets).
3. Truth-O-Meter, *Sherrod Brown Says Excessive Speculation Is Driving Gas Prices, Perhaps by 56 Cents a Gallon*, PolitiFact (May 2, 2012), *available at* http://www.politifact.com/ohio/statements/2012/may/02/sherrod-brown/sherrod-brown-says-excessive-oil-speculation-drivi/ (confirming the truth behind claims that excessive speculation is increasing oil prices).
4. Robert Lenzner, *Speculation In Crude Oil Adds $23.39 To The Price Per Barrel*, Forbes (Feb. 27, 2012), *available at* http://www.forbes.com/sites/robertlenzner/2012/02/27/speculation-in-crude-oil-adds-23-39-to-the-price-per-barrel/ (discussing Goldman Sachs's recent conclusion that oil prices are driven, in part, by speculation).
5. Les Leopold, *Wall Street's Oil Scam*, Salon (May 4, 2012), *available at* http://www.salon.com/2012/05/04/wall_streets_oil_scam/singleton/ (reporting that excessive speculation is rising the price of crude oil and threatening the United States's economic recovery).
6. Michael Greenberger, *Commodity Swap Position Limit Rule May Help Return Price-Risk Management*, Bloomberg Brief 7 (Oct. 28, 2011), *available at* http://www.michaelgreenberger.com/files/Final_Draft_Sent_Nov15.pdf (explaining how the Commodity Futures Trading Commission's final rule on position limits may reduce excessive speculation in commodities markets).
7. Michael Greenberger, *Business Day Live,* N.Y.Times (March 26, 2012), *available at* http://video.nytimes.com/video/2012/03/26/business/100000001452780/business-day-live-march-26-2012.html (discussing how speculators' activities are increasing the price of oil and the Department of Justice's failure to investigate manipulation in the oil market). Commentary begins at 4:40.
8. Michael Greenberger, *High Oil Prices Must Be Subject of Criminal Investigation*, Real News Network (March 28, 2012), *available at* http://therealnews.com/t2/index.php?option=com_content&task=view&id=31&Itemid=74&jumival=8131 (arguing that manipulation, not supply and demand, is increasing the price of crude oil and other essential commodities and explaining how an investigation into manipulation in commodities markets would reduce the price of energy and food).
9. Testimony of Michael Greenberger before the Commodity Futures Trading Commission, *Excessive Speculation: Position Limits and Exemptions* (Aug. 5, 2009), *available at* http://www.michaelgreenberger.com/files/CFTC_AFR_Sign_On_Testimony_August_3.pdf

(discussing how rigorous position limits would curb excessive speculation in commodities markets).

10. Brett Fawley, Luciana Juvenal & Ivan Petrella, *When Oil Prices Jump, Is Speculation To Blame?*, ST. LOUIS FEDERAL RESERVE, *available at* http://www.stlouisfed.org/publications/re/articles/?id=2232 (concluding that excessive speculation is increasing the price of crude oil).

Appendix B
Michael Greenberger: Brief Biography

Michael Greenberger is a professor at the University of Maryland Francis King Carey School of Law and the Founder and Director of the University of Maryland Center for Health and Homeland Security (CHHS). At the School of Law, Professor Greenberger teaches, *inter alia*, a seminar on Futures, Options and Derivatives.

In 1997, Professor Greenberger left private law practice to become the Director of the Division of Trading and Markets at the U.S. Commodity Futures Trading Commission (CFTC), where he served under CFTC Chairperson Brooksley Born. In that capacity, he was responsible for supervising exchange traded futures and derivatives. He also served on the Steering Committee of the President's Working Group on Financial Markets, and as a member of the International Organization of Securities Commissions' Hedge Fund Task Force.

Professor Greenberger has often been asked to testify before Congressional committees, regulatory agencies, and investigatory committees pertaining to the regulation of financial derivatives, including the impact of poorly regulated derivatives on the high price of commodity staples. For a full description of Professor Greenberger's testimony, writings, lectures and media appearances pertaining to derivative regulation, see **www.michaelgreenberger.com**.

Professor Greenberger has recently served as the Technical Advisor to the United Nations Commission of Experts on Reforms of the International Financial System; and on the International Energy Forum's Independent Expert Group on reducing worldwide energy price volatility.

Prior to entering government service, Professor Greenberger was a partner for over 20 years in the Washington, D.C. law firm of Shea & Gardner, where he served as lead litigation counsel before state and federal courts of law nationwide, including the United States Supreme Court.

Professor Greenberger is a Phi Beta Kappa graduate of Lafayette College and the University of Pennsylvania Law School, where he served as Editor-in-Chief of the Law Review.