Are Your Energy Dollars Slipping Through a Loophole? by Carla L. Romita
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Over the past six years, crude oil, gasoline, and natural gas prices have reached unprecedented heights. This has been a great cause for concern to consumers, especially in the Northeast, which accounts for about 80% of the nation's heating oil demand. That concern has been shared by government. In fact, the Senate Permanent Subcommittee on Investigations has been investigating the pricing of energy commodities for the past five years.

In the last several months, members of Congress have been looking into the reasons for the extraordinary volatility in the energy commodities markets. Their analysis indicates that the traditional forces of supply and demand do not fully explain the relentless price increases. It is true, of course, that global demand for oil has been increasing and, as we've discussed in this space before, that insufficient spare production capacity and political instability in producing countries threaten the reliability and security of supplies and contribute to price volatility. Hurricanes and other natural disasters in the U.S. oil and gas producing regions also have disrupted supplies and contributed to the escalating problem.
Commodities traders say that a "risk premium" is built into energy prices. Compounding this premium is the fact that large financial institutions and hedge funds pour billions of dollars into the energy commodities markets. These speculators are trading to make profits. They never take possession of the physical commodities. They have made hundreds of millions of dollars over the past few years trading energy commodities. Their enormous purchases of futures contracts create, in effect, an additional demand for product and drive up prices. It is estimated that speculation is responsible for up to $25 per barrel in the price of crude oil.

While speculative trading can bring greater liquidity to futures markets, allowing oil and gas companies who want to hedge their exposure to find counterparties willing to take on price risks, excessive trading can distort market signals of supply and demand and lead to what we are now experiencing: excess price volatility. The Commodity Futures Trading Commission is responsible for oversight of commodities markets and ensuring that prices on the futures market reflect the laws of supply and demand. CFTC regulated markets are subject to trading limits established by the CFTC in order to prevent the unreasonable price volatility and the economic burdens that places upon interstate commerce. However, the ability of the CFTC to do its work has been compromised in recent years by exponential increases in trading of energy commodities on *unregulated* exchanges. The trading of energy commodities on the unregulated over-the-counter exchanges is permitted under a provision inserted into the Commodity Futures Modernization Act of 2000—as a result extraordinary lobbying efforts by companies like Enron—that exempts OTC electronic exchanges from CFTC oversight. The legislation is called the "Enron Loophole." Before it was passed, crude oil traded under $25 per barrel; now it approaches $100 per barrel. Today, up to 75% of energy commodities trading takes place on unregulated "dark" markets, as opposed to regulated markets like the NYMEX.
High oil prices hurt consumers, but they also squeeze the margins of local heating oil dealers by creating higher finance costs, stressing credit lines, and expanding accounts receivable. On October 26, 2007, the New York Oilheating Association wrote to Senator Charles Schumer (D-NY) asking him to co-sponsor a bill recently introduced by Sen. Carl Levin (D-Mich.) to close the Enron Loophole. That Loophole was blamed for the collapse of mega-hedge fund Amaranth Advisors, which evaded regulators trying to limit its positions in the U.S. natural gas market. The Loophole permits traders to operate in electronic energy markets without federal oversight. "In light of unprecedented speculation and volatility in the energy commodity markets, it is time to close the gaps in federal law that allow energy profiteers to distort the price of energy for personal gain," the letter said. NYHOA represents local businesses who distribute heating oil within New York City. As financial speculators wantonly abuse opaque markets for personal profit, there is a growing lack of consumer confidence in the market's ability to set a price for energy based on economic fundamentals, according to NYOHA's Executive Vice President, John Maniscalco. Excessive speculation and manipulation of energy prices on "dark" markets have severely shaken public confidence. The energy markets should be completely transparent and subject to regulatory oversight so that the prices reflect the fundamental forces of supply and demand, not the manipulation of deep pocket speculators who reap millions at the expense of the energy consuming public and economic security of our nation. The New York Oilheating Association has joined its resources with other regional trade associations to petition Congress to make all energy exchanges subject to CFTC oversight in order to prevent such abuses.

Senator Levin's bill is called the "Oil and Gas Traders Oversight Act." It would close the Enron Loophole and bring accountability to the "dark" markets. Congress should pass this bill, put an end to the market manipulation by financial giants, and restore sanity and public confidence in a fair marketplace.