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ICE, ICE, Baby

Special to the Star-Telegram

"There's a few hedge fund managers out there who are masters at knowing how to exploit the peak [oil] theories and hot buttons of supply and demand and by making bold predictions of shocking price advancements to come, they only add more fuel to the bullish fire in a sort of self fulfilling prophecy." — *National Gas Week*, September 5, 2005 as reprinted in the US Senate Permanent Subcommittee on Investigations' report, "The Role of Market Speculation in Rising Oil and Gas Prices," June 27, 2006

Fiddling While We Burn

There it is in plain sight for everyone to see, exactly what I've been reporting for the past few years: Many individuals who are investing in oil and natural gas futures are going out in the media and trying to convince the American public that either we are out of oil or there is a serious supply shortage of crude against worldwide demand. The question is: Does it surprise you to discover that the US Senate investigated the rigging of the oil market by speculators in the summer of 2006 – and concluded that there was no supply and demand problem with oil? Did you know that their conclusion was that speculators were responsible for a 70 percent overcharge in the price of oil in the months leading up to the summer of 2006?

This from page 1 of the Executive Summary of that Senate investigation, there is this one troubling line: "Today, U.S. oil inventories are at an eight-year high, and OECD (Organization for Economic Co-operation and Development) oil inventories are at a 20-year high."

That's odd because, in 2006, just like today, the media reporting covered the serious international shortage of oil and justified oil's high price. Even more troubling is that the House of Representatives held a hearing this past December, ominously titled "Energy Speculation and Price Manipulation." How did it pass under the radar that both the Senate and the House studied the issue of price manipulation in our energy markets and both concluded that it was unregulated, massive trading in one futures market that was really driving up the price of oil and natural gas? And given that conclusion, why has Congress done nothing about it?

Investors Make the News, Literally

A week ago Goldman Sachs issued a new investor note, suggesting that somewhere between six months to two years, the price of oil could go into a "super spike" and prices jump as high as $200 per barrel. It became the major story of the night. Ignored in the reporting frenzy was that many legitimate and well-respected oil analysts dismissed Goldman Sachs' prediction as groundless.

Get ready for the next shock to your system. In the past month we have added 11.9 million barrels of oil into our stock reserves, giving us 32.3 million more barrels of oil than we had on hand January 1. On May 5, we found out that for the second time in as many years, Iran was storing its excess crude oil on tankers in the Persian Gulf, because it had run out of storage space in the desert and was awaiting buyers for its heavy crude. That same day Saudi Arabia cut the discount price for its Arabian Heavy crude to $7.45, hoping to entice more buyers for immediate delivery. We didn't hear that news, either.

While researching my third article for *BusinessWeek* online about the world's oil situation in 2008, I asked for the most current report from Oil Movements. Because the oil industry is not transparent, Oil Movements tracks every tanker at sea, from both OPEC and non-OPEC oil countries, along with their cargoes' final destinations. Anne O'Shea responded immediately to my request with their report dated May 8, 2008. Just so you will know, oil shipments are up from a year ago in almost every class, including Middle East oil in transit and Non-OPEC in Transit. The only class of oil shipment that has declined is covered on page 3 of that report. That chart is labeled, "4-Week Changes in Westbound Oil at Sea."

That's right, shipments of oil headed west have shown serious declines during the month of April, down 800,000 barrels per day in the week before the publication of the report. Now, let me give you the first line from under the Westbound Oil shipments chart: "In the west, a big share of any [oil] stock building done this year has happened offshore, *out of sight*."

Could this be true? Oil Movements, the unimpeachable source for finding the real world situation on oil transits, is saying that oil is being hidden offshore, not declared in inventories? Yes, that is exactly what they are saying.

That same week our refineries cut their production runs back to 85 percent, down from 89 percent a year ago, to trim more gasoline out of our stock reserves, to increase their profits per gallon.

National Short-Term Memory Loss

It's amazing how quickly we forget our recent history. Congressional hearings in 2001, blasting certain Wall Street executives for using the media to sell the public on stocks in order to bid up the price – so their firm could divest of its shares without taking a beating. Meanwhile, other trusted advisors pushed stocks that were fundamentally worthless, because their affiliated banks had large loan agreements with those companies.

The year before Enron had been caught manipulating the California energy market, even forcing rolling blackouts across the northern part of their state apparently just for effect – to support their claim that there just wasn't enough electricity to go around. Again, we now know that claim was untrue. It was Enron shutting down certain power generation plants, while placing bets on their unregulated energy futures market. The net cost to California consumers was almost $8 billion.

It didn't end there. Amaranth Advisors, a hedge fund, literally was cornering the market on natural gas futures, to make it appear that there was a shortage of natural gas, when the Commodities Futures Trading Commission told Amaranth to liquidate its position on the NYMEX because its bidding had already moved natural gas prices far beyond the reasonable limits of supply and demand. Now, remember this name: ICE, short for Intercontinental Exchange – the "dark futures lookalike market."

Once the CFTC told it to back off its natural gas futures contracts, Amaranth simply shifted gears, got out of the NYMEX, placed its massive bets outside of government regulation in ICE and managed to drive natural gas futures to $8.50 per MBtu.

As the Senate investigation into the manipulation of the energy markets showed, "Amaranth – the day before they failed, natural gas was about $8.50; the day after it failed, it went to $4.46 MBtu." That's right, one major hedge fund managed to double the price of natural gas simply by loading up on futures contracts; when the government told them their bets were unwarranted, they simply moved their monies to a futures exchange that was unregulated. Only when Amaranth failed did natural gas prices fall back to what was considered normal for supply and demand.

Sadly, like oil today, when this was happening we were being told that natural gas supplies were tight worldwide. That statement simply wasn't true.

Dark Future

Likewise, British Petroleum was busted for manipulating the propane market in the winter of 2004 and fined $373 million. Of course, in Texas, under deregulation of our public utilities, our electric rates can be set using the futures market for natural gas, so the manipulation of the natural gas market spelled trouble for us. Consider this, by 2006, according to www.powertochoose.org, electricity rates for us had climbed to 15 cents a kilowatt-hour due to the high cost of natural gas. But, that was the exact same time period that Amaranth was proven to be manipulating the market and sending natural gas futures through the roof. Two months later the hedge fund collapsed and natural gas prices fell. Therefore, most Texans paid higher electric bills for Amaranth's manipulation of the natural gas market.

Professor Michael Greenberger of the University of Maryland, a former board member of the Commodities Futures Trading Commission, testified in front of the House Committee on Energy and Commerce on December 14 of last year. Under discussion that day was the manipulation of the energy markets and prices, but Professor Greenberger added these comments: "Three, four months from now, you're going to have a hearing on the subprime meltdown, and you're going to find that the very same legislation [deregulating energy] deregulated something called collateralized debt obligations, CDOs." That legislation, friends, directly ties the mortgage meltdown to the high price of energy today.

It was called H.R. 5660, the Commodities Futures Modernization Act of 2000. At first this bill went nowhere in the House, not even up for debate. Then, a few months later, late one night a 242-page bill written by Wall Street lawyers, with the exact same name as the former House bill, was quietly added to an 11,000-page appropriations bill, and the Enron loophole was created. The power behind that bill was one Texas Senator, one Texas Congressman and their wives.

Next week: How the unregulated futures market pushes the price of oil, natural gas and gasoline far beyond those commodities' market value, thanks to the creation of the Intercontinental Exchange. Worse, Congress knows this, but does nothing.

Ed Wallace is a recipient of the Gerald R. Loeb Award for business journalism, given by the Anderson School of Business at UCLA, and is a member of the American Historical Society. He reviews new cars every Friday morning at 7:15 on Fox Four's *Good Day*, contributes articles to *BusinessWeek* Online and hosts the talk show, *Wheels*, 8:00 to 1:00 Saturdays on 570 KLIF. E-mail: wheels570@sbcglobal.net

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ICE, ICE, Baby, conclusion

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"What's been happening since 2004 is very high prices without record-low [oil] stocks. The relationship between U.S. [oil] inventory levels and prices has been shredded and become irrelevant."

— Jan Stuart, Global Oil Economist, UBS Securities

"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."

— Tim Evans, Senior Oil Analyst, IFR Energy Services [From testimony: U.S. Senate Permanent Subcommittee on Investigations' report, "The Role of Market Speculation in Rising Oil and Gas Prices," June 27, 2006]

The Love of Money

Record high prices without record low oil inventories, analysts saying that so much money flows into oil commodities that it gives the impression of shortages, when in fact no shortage exists. That mirrors the situation in the commodities market for food, as Bloomberg pointed out in its April 28 article, "Wall Street Grain Hoarding Brings Farmers, Consumers Near Ruin": "Commodity investors control more U.S. crops than ever before, competing with governments and consumers for dwindling food supplies." That's right; food, oil and gasoline have become an "asset class." No longer are you fighting a neighbor at the supermarket over the last box of Cheerios®; now you're fighting the futures traders, who are actually determining what you will pay for that cereal.

We started as a society that worships hard labor and the basic business ethic of building value into the goods you create. How'd we get from there to worshiping Wall Street's billion-dollar boys — who create nothing, build nothing, own nothing and deliver no goods, and yet can throw so much money into products made by others that they determine what we consumers will pay for those goods?

It wasn't always this way.

In the past, the Commodities Futures Trading Commission acted as the cop on the beat, ensuring that buyers in the market were not distorting or manipulating prices beyond what supply and demand normally dictate. Certainly, if a hard frost hit Florida and cost growers an orange crop, then bidding up the price of the remaining oranges was both a wise investment and allowed under the trading rules. Right now investors know that if they borrow and invest huge amounts in commodities futures, they can create a shortage on paper – which drives prices up just like an actual shortage of any given product would. What kept traders from cornering the market that way in the past were the government's anti-manipulation rules.

Lay, DeLay, Gramm, Gramm & Clinton

The late, infamous Enron head, Ken Lay, realized in the eighties that he could make more money bidding up energy in the futures market than by actually creating and selling energy. But, under then-current rules, how much you could make swapping paper was limited. Fortuitously, Lay had excellent Texas political connections; and in November of 1992, the head of the Commodities Futures Trading Commission moved to exempt energy-derivative contracts and related swaps from any government oversight.

A vote was hurriedly put together before the Clinton White House would take over, and so Lay could finally start "dark" – unregulated – futures trading. The head of the CFTC was Wendy Gramm, wife of Texas Senator Phil Gramm; five weeks after she left, she became a board member of Enron in Houston.

Fast-forward to late 2000 and H.R. 5660, the Commodity Futures Modernization Act of 2000, sponsored by Republican Congressman Thomas Ewing of Illinois. That bill went nowhere, even though Tom Delay's wife Christine was then working for a Washington lobbying firm, Alexander Strategies – which Enron had paid $200,000 to push through legislation for permanent energy deregulation in these "dark" markets.

Six months later came Senate Bill 3283, also named the Commodity Futures Modernization Act of 2000. This time around the sponsor was Republican Sen. Richard Lugar of Indiana, and now Phil Gramm was listed as one of the bill's co-sponsors. Like it had in the House, this bill was destined to go nowhere until, late one night, it was attached as a rider to an 11,000-page appropriations bill – which was signed into law by President Clinton.

Now traders had an officially deregulated market for energy futures. Worse, that bill also deregulated many financial instruments – including the collateralized debt obligations that are at the center of today's mortgage crisis, which may well cost us more than $1 trillion before it's over.

Everybody Was Warned!

As *USA Today* wrote of this fiasco in January of 2002, "But, as a power marketer, [Enron] could buy enough energy-futures contracts in a region to create a virtual monopoly." That's right: As early as the winter of 2002, it was widely known that the 2000 Commodities Futures Modernization Act had created a monster, capable of running up energy prices outside of the normal law of supply and demand. Worse, our government had been warned this was going to happen. Representatives of the Federal Reserve, the Securities and Exchange Commission and the CFTC had already told Congress not to deregulate energy because "the market was ripe for manipulation." Everybody was warned; that's why this deregulation bill was stealthily inserted into that appropriations bill without a floor debate.

Phil Gramm's office denied that he had anything to do with writing the section of that bill that actually deregulated energy. And yet Prof. Michael Greenberger, formerly a CFTC board member himself, said that Gramm's wife Wendy, along with a few lobbyists and Wall Street attorneys, had rewritten it. When Robert Manor of the *Chicago Times* wrote about this situation on January 18, 2002, neither Gramm could be reached for comment.

Kill It Before It Multiplies

When Enron failed and took its private, unregulated energy exchange to the grave, another rose to take its place. The Intercontinental Exchange (ICE) was the brainchild of Morgan Stanley, Goldman Sachs, British Petroleum, Deutsche Bank, Dean Witter, Royal Dutch Shell, SG Investment Bank and Totalfina. In 2001 ICE purchased the International Petroleum Exchange in London; renamed ICE Futures, it now operates as an "exempt commercial market" under section 2(H)(3) of the Commodity Exchange Act. As the Senate hearings pointed out in the summer of 2006, "Both markets operate outside of any CFTC oversight."

If you reread the quotes at the start of this story again, you find that many officials in the government warned against what would happen in a deregulated energy market, because it was so easy to manipulate. We already know this to be true thanks to Enron's California misdeeds. And, as we pointed out last week, British Petroleum was busted for manipulating the propane market and fined over $300 million; and Amaranth Partners was caught manipulating the natural gas market, unconscionably causing the futures price for natural gas to raise every Texan's electric bills. (It took two years for Amaranth to be exposed.) And yes, the manipulation happened in the new "dark" and unregulated exchanges, making it almost impossible to uncover. So it's not a question of "if" some "theoretically possible" manipulation and distortion of the market will result from this bill, championed by Phil Gramm, his wife Wendy and Christine Delay's employer, Alexander Strategies. The reason it is not theoretical is because we keep catching well-known companies doing it on a regular basis.

No Conscience in Congress?

All you hear daily is that the world has a severe shortage of oil, or you can buy only 200 pounds of rice at one time, or we will have a gasoline crisis this summer, etc. But it takes only a minute to find hundreds of quotes from highly respected oil and economic analysts, (not to mention CEOs of the major oil companies), that completely dismiss the claim of oil, gas or food shortages that have been headlining the news.

Even more troubling is that within months of the CFMA's going into effect, we knew it had enabled easy manipulation of any energy market, but nothing was done to fix it. Nor was anything done when the Senate held its hearings on this matter in 2006, or in the House hearings last December.

Today we call this situation the "Enron Loophole," but that's untrue. It's not a loophole: it was a new law passed in 2000 – and far more individuals than Ken Lay have used that law to line their pockets with hundreds of billions of American consumers' hard-earned dollars. That's not my opinion, that's direct testimony by numerous experts before both the House and Senate.

Professor Greenberger warned about our "New American Economy" far better than I could:

"Should we have an economy that's based on whether people make good or bad bets? Or should we have an economy where people build companies, create manufacturing, do inventions, advance the American society and make it more productive? We are rewarding people for sitting at their computers and punching in bets. That's not the way our economy is going to be built, and India and China, with their focus on science and industry and building real businesses, are going to eat our lunch, unless the American public wakes up and puts an end to an economy that praises and makes heroes out of speculators."

Greenberger's statement explains why Detroit and other American manufacturers suffer while Wall Street speculators make a fortune — and your rapidly shrinking checkbook pays for it, every time you buy food, fuel or feed.

All because there is no shortage of these goods, you're just being told there is because it's more profitable – for a few – that way.

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