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Standard Oil Rises Again: How Eroding Legal Protections and Lax Regulatory Oversight Harm Consumers*

By Tyson Slocum⁺

Introduction

Recent legislative and regulatory changes have weakened government oversight of oil and natural gas markets, and have re-

* This article is partly a compilation of statements and testimony made on behalf of Public Citizen, including: Causes and Solutions of New Jersey's High Gasoline Prices: Hearing before the New Jersey Assembly Transportation Committee (2005) [hereinafter *New Jersey's High Gasoline Prices*], (Testimony of Tyson Slocum, Research Director of Public Citizen's Energy Program), available at <http://www.citizen.org/cmep/energy%5Fenviro%5Fnuclear/electricity/Oil%5Fand%5FGas/articles.cfm?ID=14156> (last visited Apr 23, 2007); The Need for Stronger Regulation of U.S. Natural Gas Markets: Hearing before the House Government Reform subcommittee on Energy and Resources (2005) [hereinafter *The Need for Stronger Regulation of U.S. Natural Gas Markets*] (Testimony of Tyson Slocum, Research Director of Public Citizen's Energy Program), available at <http://www.citizen.org/documents/Natural%20Gas%20Testimony.pdf>, (last visited Apr. 23, 2007); and Consumer Concerns with Natural Gas and LNG: Hearing before the Competition, Foreign Commerce and Infrastructure of the U.S. Senate committee on Commerce, Science and Transportation (2004) [hereinafter *Consumer Concerns with Natural Gas*] (Testimony of Wenoah Hauter, Director of Public Citizen's Energy Program), available at <http://www.citizen.org/documents/NatGasTestimony10-04.pdf> (last visited Apr. 23, 2007). Further, the author participated in a panel presentation concerning these topics at the Federal Trade Comm., Energy Markets in the 21st Century (Apr. 10-12, 2007).

⁺ Director, Public Citizen's Energy Program. Public Citizen is a national, non-profit consumer advocacy organization founded in 1971 to represent consumer interests in Congress, the executive branch and the courts. Public Citizen's energy program safeguards consumers from the impacts of electricity deregulation, educates the public on the dangers of nuclear power while encouraging responsible nuclear waste management, and fights against environmental degradation by promoting clean energy alternatives. For more information, please visit www.publiccitizen.org.

sulted in a greater ability of energy companies to engage in anti-competitive behavior. This article will explore these changes and provide some reform options to help restore basic consumer protections in the energy marketplace.

Since 2001, the largest five oil companies operating in the United States—ExxonMobil, ChevronTexaco, ConocoPhillips, BP and Shell—recorded \$464 billion in profits.¹ While some of their profit clearly stems from certain aspects of global supply and demand, investigations show that a portion of these record earnings are fueled by market manipulation, made possible by recent mergers² and weak regulatory oversight by the federal government.³

Energy trading markets, where prices of oil and gasoline are set, were recently deregulated, providing new opportunities for oil companies and financial firms to manipulate prices.⁴ Investigations show that energy trading firms have not only exploited recently weakened regulatory oversight, but a new trend of energy traders controlling energy infrastructure assets, like pipelines and storage facilities, provides additional abilities to use “insider” information to help manipulate markets.⁵

A wave of mergers in the oil and gas industry, has led to greater levels of market power and industry consolidation, thereby making anti-competitive practices by a handful of oil companies increasingly possible.⁶ As industry consolidation has reached a peak, the recently strong bias of in the antitrust area in favor of a rule of reason rather than a per se analysis of alleged anticompetitive conduct, weakened anti-trust enforcement.⁷ This judicial weakening of anti-trust law, combined with lax regulatory oversight by the US Federal Trade Commission (FTC), allowed oil companies to merge operations and forge joint partnerships that undermine effective com-

¹ Public Citizen calculations from company financial reports filed with the U.S. Securities and Exchange Commission.

² *New Jersey High Gasoline Prices I*, *supra* note 1.

³ *The Role Of Market Speculation In Rising Oil And Gas Prices: A Need To Put The Cop Back On The Beat*, Staff Report prepared by the Perm. Subcomm. on Investigations of the Committee on Homeland Security and Governmental Affairs of the U.S. Senate, June 27, 2006, found at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_senate_committee_prints&docid=f:28640.pdf

⁴ See discussion *infra* Section III

⁵ See discussion *infra* Section II

⁶ *New Jersey's High Gasoline Prices*, *supra* note 1.

⁷ See discussion *infra* Section III and IV

petition in domestic downstream oil markets.⁸

I. Energy Trading Abuses Require Stronger Oversight

Two regulatory lapses are enabling anti-competitive practices in energy trading markets where prices of energy are set. First, oil companies, investment banks and hedge funds are exploiting recently deregulated energy trading markets to manipulate energy prices.⁹ Second, energy traders are speculating information gleaned from their own company's energy infrastructure affiliates, a type of legal "insider trading."¹⁰

Contrary to some public opinion, oil prices are not set by the Organization of Petroleum Exporting Countries (OPEC); rather, prices are determined every day by the actions of investment banks, hedge funds and oil company energy traders in the energy markets.¹¹ Historically, most crude oil has been purchased through either fixed-term contracts or on the "spot" market.¹² Long-standing futures markets exist for crude oil, led by the New York Mercantile Exchange (NYMEX) and London's International Petroleum Exchange, which was acquired in 2001 by an Atlanta-based electronic over-the-counter (OTC) exchange, the Intercontinental Exchange (ICE).¹³ NYMEX is a floor exchange regulated by the U.S. Commodity Futures Trading Commission (CFTC).¹⁴ The futures market historically serves to hedge risks against price volatility and also serves for price discovery.¹⁵ Only a tiny fraction of futures trades result in the physical de-

⁸ See discussion *infra* Section III

⁹ STAFF OF THE PERM, SUBCOMM. ON INVESTIGATIONS OF THE S. COMM. ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, 109TH CONG., REPORT ON THE ROLE OF MARKET SPECULATION IN RISING OIL AND GAS PRICES: A NEED TO PUT THE COP BACK ON THE BEAT, [hereinafter, THE ROLE OF MARKET SPECULATION] available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_senate_committee_prints&docid=f:28640.pdf (last visited Apr. 23, 2007).

¹⁰ See discussion *infra* Section II.

¹¹ See *New Jersey High Gasoline Prices supra* note 1. THE ROLE OF MARKET SPECULATION, *supra* note 9.

¹² THE ROLE OF MARKET, SPECULATION *supra* note 9.

¹³ ICE - History, <https://www.theice.com/history.jhtml> (last visited Apr. 20, 2007); NYMEX - An Introduction, <http://www.nymex.com/intro.aspx> (last visited April 20, 2007).

¹⁴ THE ROLE OF MARKET SPECULATION, *supra* note 9, at 4.

¹⁵ *Hearing Before the H. Comm. on Energy and Commerce*, 109th Cong.

livery of crude oil.¹⁶

The CFTC enforces the Commodity Exchange Act, which gives the Commission authority to investigate and prosecute market manipulation.¹⁷ But after a series of deregulation moves by the CFTC and Congress, the futures markets, over the last few years, have increasingly been driven by the unregulated OTC market.¹⁸ The deregulated OTC markets serve more as purely speculative markets, rather than the traditional volatility hedging or price discovery because the lack of regulation invites companies to engage in anti-competitive practices.¹⁹ And more importantly, this new speculative activity is occurring outside the regulatory jurisdiction of the CFTC.²⁰

Energy trading markets were deregulated in two steps: first, in 1993, the CFTC regulatory process began, and second, Congressional action followed in 2000²¹.

In response to a petition by nine energy and financial companies, led by Enron,²² on November 16, 1992, then-Commodity Futures Trading Commission Chairwoman Wendy Gramm muscled through a rule change—later known as Rule 35—that exempted certain energy trading contracts from the requirement that all futures contracts be traded on a regulated exchange like NYMEX, thereby allowing companies like Enron and Goldman Sachs to trade energy contracts between themselves outside regulated exchanges.²³ Impor-

(2005) (statement of Dr. James Newsome, President, New York Mercantile Exchange, Inc), available at <http://energycommerce.house.gov/reparchives/108/Hearings/09072005hearing1630/Newsome.pdf> (last visited Apr. 23, 2007).

¹⁶ MINORITY STAFF OF THE PERM SUBCOMM ON INVESTIGATIONS OF S. COMM. ON GOVERNMENTAL AFFAIRS, 105TH CONG., REPORT ON U.S. STRATEGIC PETROLEUM RESERVE: RECENT POLICY HAS INCREASED COSTS TO CONSUMERS BUT NOT OVERALL U.S. ENERGY SECURITY, (Comm. Print 2003). available at <http://a257.g.akamaitech.net/7/257/2422/05jun20031230/www.access.gpo.gov/congress/senate/pdf/108hr/85551.pdf> (last visited Apr. 23, 2007)

¹⁷ 7 U.S.C. §§ 9, 13b., 13(a)(2) (West 2007).

¹⁸ THE ROLE OF MARKET SPECULATION *supra* note 9 at 4.

¹⁹ THE ROLE OF MARKET SPECULATION *supra* note 9 at 32

²⁰ *Id.*

²¹ Commodity Futures Modernization Act of 2000, Pub. L. 106-554, 7 U.S.C.A §5, et. seq. (2000).

²² The other eight companies were: BP, Coastal Corp (now El Paso Corp.) Conoco and Phillips (now ConocoPhillips), Goldman Sachs' J. Aron & Co, Koch Industries, Mobil (now ExxonMobil) and Phibro Energy (now a subsidiary of Citi-Group).

²³ Public Citizen's Critical Mass Energy & Environment. Program, *Blind Faith: How Deregulation and Enron's Influence Over Government Looted Billions*

tantly, the new rule also exempts energy “swaps”—a bilateral agreement to “swap” a commodity for a certain price at a certain date—from the anti-fraud provisions of the Commodity Exchange Act.²⁴ At the same time, Gramm initiated a proposed order granting a similar exemption to large commercial participants in various energy contracts that was later approved in April 2003.²⁵

Of the nine companies writing letters of support for the rule change, Enron made by far the largest contributions to Wendy Gramm’s husband, then Texas Senator Phil Gramm’s campaign fund at that time, donating \$34,100.²⁶

Wendy Gramm’s decision was controversial. Then-U.S. Rep. Glen English, then-chairman of a House Agriculture subcommittee with jurisdiction over the CFTC and current CEO of the National Rural Electric Cooperative Association, protested that Wendy Gramm’s action prevented the CFTC from intervening in basic energy futures contracts disputes, even in cases of fraud, noting that “in my 18 years in Congress this [Gramm’s vote to deregulate] is the most irresponsible decision I have come across.”²⁷ Sheila Bair, the CFTC commissioner casting the lone dissenting vote, argued that deregulation of energy futures contracts “sets a dangerous precedent.”²⁸ A U.S. General Accounting Office report issued a year later urged Congress to increase regulatory oversight over derivative contracts,²⁹ and a congressional inquiry found that CFTC staff analysts and economists believed Gramm’s hasty move prevented adequate policy review.³⁰

from *Americans* (Dec. 2001), available at http://www.citizen.org/cmep/energy_enviro_nuclear/electricity/Enron/articles.cfm?ID=7104 [hereinafter *Blind Faith*]; Jim Drinkard & Greg Farell, *Enron Made A Sound Investment in Washington*, USA TODAY, Jan 24, 2002 at A1.

²⁴ See 17 C.F.R. §1 (2006), available at www.access.gpo.gov/nara/cfr/waisidx_06/17cfr35_06.html (last visited Apr. 23, 2007).

²⁵ “Exemption for Certain Contracts Involving Energy Products,” 58 Fed. Reg. 6250 (1993).

²⁶ Charles Lewis, *The Buying of the President 1996*, 153. (The Center for Public Integrity) (1996).

²⁷ *Blind Faith* supra note 22, at 12; *Forward-Contract Fraud Exception May be Reversed, Says Congressman*. Inside F.E.R.C. Gas Market report, May 7, 1993 at Derivatives Trading 4.

²⁸ *Forward-Contract Fraud Exception May be Reversed, Says Congressman*. Inside F.E.R.C. Gas Market report, May 7, 1993 at Derivatives Trading 4.

²⁹ See generally, G.A O REPORT ON FINANCIAL DERIVATIVES: ACTIONS NEEDED TO PROTECT THE FINANCIAL SYSTEM, 8-9 (May 18, 1994), available at <http://archive.gao.gov/t2pbat3/151647.pdf> (last visited Apr. 23, 2007)

³⁰ *Blind Faith*, supra note 22; Brent Walth & Jim Barnett, “A Web of Influ-

Five weeks after pushing through the “Enron loophole,” Wendy Gramm was asked by Kenneth Lay to serve on Enron’s Board of Directors.³¹ When asked to comment about Gramm’s nearly immediate retention by Enron, Lay called it “convoluted” to question the propriety of naming her to the board.³²

Congress followed Wendy Gramm’s lead in deregulating energy trading contracts and moved to deregulate energy trading *exchanges* by exempting electronic exchanges, like those quickly set up by Enron, from regulatory oversight. These unregulated exchanges contrast with traditional trading floors like NYMEX that remained regulated.³³ Congress took this action during last-minute legislative maneuvering on behalf of Enron by former Texas GOP Senator Gramm in the lame-duck Congress two days after the Supreme Court ruled in *Bush v Gore*,³⁴ buried in 712 pages of unrelated legislation.³⁵ As Public Citizen, the nation’s largest consumer advocacy organization, pointed out back in 2001, this law deregulated over-the-counter (OTC) derivatives energy trading by “exempting such trading from the Commodity Exchange Act, removing anti-fraud and anti-manipulation regulation over these derivatives markets and exempting “electronic” exchanges from CFTC regulatory oversight.”³⁶

The OTC derivatives energy trading deregulation law was passed against the explicit recommendations of a multi-agency review of derivatives markets.³⁷ The November 1999 release of a report by the President’s Working Group on Financial Markets—(a multi-agency policy group with permanent standing composed at the time of Lawrence Summers, Secretary of the Treasury; Alan Greenspan, Chairman of the Federal Reserve; Arthur Levitt, Chairman of the Se-

ence,” PORTLAND OREGONIAN, Dec. 8, 1996.

³¹ Frontline: So You Want to Buy a President, Wendy Gramm (last visited Apr. 8, 2007), <http://www.pbs.org/wgbh/pages/frontline/president/players/gramm.html>

³² Blind Faith, *supra* note 22 (quoting Jerry Knight, *Energy Firm Finds Ally, Director, in CFTC Ex-Chief*, WASHINGTON POST, (Apr. 17, 1993).)

³³ See *supra* Section II.

³⁴ *Bush v. Gore*, 531 U.S. 98 (2000).

³⁵ See generally, Pub. L. No. 106-554, available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=106_cong_public_laws&docid=f:publ554.106.pdf (last visited Apr. 23, 2007) (*stating* HR 5660, amending H.R.4577, now, Appendix E).

³⁶ See Blind Faith, *supra* note 22.

³⁷ See Report of the President’s Working Group on Fin. Markets: Over-the-Counter Derivatives Markets and the Commodity Exchange Act, available at www.ustreas.gov/press/releases/docs/otcact.pdf (last visited Mar. 23, 2007).

curities and Exchange Commission; and William Rainer, Chairman of the CFTC)—concluded that energy trading must not be deregulated. The Group reasoned that “due to the characteristics of markets for nonfinancial commodities with finite supplies . . . the Working Group is unanimously recommending that the [regulatory] exclusion not be extended to agreements involving such commodities.”³⁸

As a result of the Commodity Futures Modernization Act,³⁹ trading in unregulated OTC exchanges is growing. Trading volume on the ICE has skyrocketed, with the 93 million contracts traded in 2006 representing a 120 percent increase from 2005, and the 12.6 million contracts traded in January 2007 a 166 percent increase from a year earlier.⁴⁰

The founding members of ICE include Goldman Sachs, BP, Shell and Totalfina Elf.⁴¹ In November 2005, ICE became a publicly traded corporation.⁴² Goldman Sachs remains a significant shareholder of ICE, owning about 7.4 percent of the exchange’s shares, while Morgan Stanley owns 7.3 percent and BP 5 percent.⁴³

Goldman Sachs’ trading unit, J. Aron, is one of the largest and most powerful energy traders in the United States, and commodities trading represents a significant source of revenue and profits for the company.⁴⁴ Goldman Sachs’ most recent 10-K filed with the U.S. Securities and Exchange Commission shows that Fixed Income, Currency and Commodities, which includes energy trading, generated nearly 40 percent of Goldman’s \$37.7 billion in revenue for 2006.⁴⁵

In the summer of 2006, Goldman Sachs, which at the time

³⁸ *See Id.*

³⁹ Commodity Futures Modernization Act of 2000, Pub. L. 106-554, 7 U.S.C.A §5, et. seq. (2000).

⁴⁰ InterContinental Exchange, Inc., located at www.theice.com/exchange_volumes_2005.jhtml (last visited Apr. 24, 2007).

⁴¹ *See* United States Securities and Exchange Commission Form S-1, available at <http://www.sec.gov/Archives/edgar/data/1174746/000095012305003467/y0540sv1.htm> (last visited Apr. 24, 2007)

⁴² *See* United States Securities and Exchange Commission Form 10-K available at <http://www.sec.gov/Archives/edgar/data/1174746/000095014407001603/g05422e10vk.htm> (last visited Apr.24, 2007).

⁴³ Yahoo! Finance, available at <http://finance.yahoo.com/q/mh?s=ICE> (last visited Apr. 24, 2007).

⁴⁴ *See* The Goldman Sachs Group, Inc. Form 10-K 6 (Feb. 5, 2007), available at http://www2.goldmansachs.com/our_firm/investor_relations/financial_reports/docs/2006_Form_10-K.pdf (last visited Apr. 24, 2007).

⁴⁵ *Id.*

operated the largest commodity index, GSCI, announced it was radically changing the index's weighting of gasoline futures, selling about \$6 billion worth of gasoline.⁴⁶ As a result of this weighting change, Goldman Sachs helped cause gasoline futures prices to fall nearly 10 percent.⁴⁷

A recent bipartisan U.S. Senate investigation summed up the negative impacts on oil prices with this shift towards unregulated energy trading speculation:

[O]ver the last few years, large financial institutions, hedge funds, pension funds, and other investment funds have been pouring billions of dollars into the energy commodity markets—perhaps as much as \$60 billion in the regulated U.S. oil futures market alone. . . The large purchases of crude oil futures contracts by speculators have, in effect, created an additional demand for oil, driving up the price of oil to be delivered in the future in the same manner that additional demand for the immediate delivery of a physical barrel of oil drives up the price on the spot market. . . Several analysts have estimated that speculative purchases of oil futures have added as much as \$20–\$25 per barrel to the current price of crude oil. . . large speculative buying or selling of futures contracts can distort the market signals regarding supply and demand in the physical market or lead to excessive price volatility, either of which can cause a cascade of consequences detrimental to the overall economy. . . At the same time that there has been a huge influx of speculative dollars in energy commodities, the CFTC's ability to monitor the nature, extent, and effect of this speculation has been diminishing. Most significantly, there has been an explosion of trading of U.S. energy commodities on exchanges that are not regulated by the CFTC. . . in contrast to trades conducted on the NYMEX, traders on unregulated OTC electronic exchanges are not required to keep records or file Large Trader Reports with the CFTC, and these trades are exempt from routine CFTC oversights. In contrast to trades conducted on regulated futures exchanges, there is no limit on the number of contracts a speculator may hold on an unregulated OTC electronic exchange, no monitoring of trading by the exchange itself, and no report-

⁴⁶ Heather Timmons, *Change in Goldman Index Was Factor in Gas Price Drop*, N.Y. TIMES, Sept. 30, 2006, at C1.

⁴⁷ *Id.*

ing of the amount of outstanding contracts (“open interest”) at the end of each day.⁴⁸

Thanks to the Commodity Futures Modernization Act⁴⁹, participants in these newly-deregulated energy trading markets are not required to file so-called Large Trader Reports⁵⁰, the records of all trades that NYMEX traders are required to report to the CFTC, along with daily price and volume information.⁵¹ The Large Trader Reports, together with the price and volume data, are the primary tools of the CFTC’s regulatory regime: “[t]he Commission’s Large Trader information system is one of the cornerstones of our surveillance program and enables detection of concentrated and coordinated positions that might be used by one or more traders to attempt manipulation.”⁵² So the deregulation of OTC markets, by allowing traders to escape such basic information reporting, leave federal regulators with no tools to routinely determine whether market manipulation is occurring in energy trading markets.

Oil companies, investment banks and hedge funds are exploiting the lack of government oversight to price-gouge consumers and make billions of dollars in profits. These energy traders boast about how they are price-gouging Americans, as a recent *Dow Jones* article makes clear: energy “traders who profited enormously on the supply crunch following Hurricane Katrina cashed out of the market ahead of the long weekend. ‘There are traders who made so much money

⁴⁸ STAFF OF THE PERM, SUBCOMM. ON INVESTIGATIONS OF THE S. COMM. ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, 109TH CONG., REPORT ON THE ROLE OF MARKET SPECULATION IN RISING OIL AND GAS PRICES: A NEED TO PUT THE COP BACK ON THE BEAT, [hereinafter, THE ROLE OF MARKET SPECULATION] available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_senate_committee_prints&docid=f:28640.pdf (last visited Apr. 23, 2007).

⁴⁹ See 7 U.S.C. §5, et. seq (2000).

⁵⁰ See *Implementation of the Commodity Futures Modernization Act* (discussing large trader reporting requirements), available at http://www.arnoldporter.com/pubs/files/11_2001f.pdf (last visited Apr. 26, 2007).

⁵¹ The Role Of Market Speculation In Rising Oil And Gas Prices: A Need To Put The Cop Back On The Beat, Staff Report prepared by the Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs of the U.S. Senate, June 27, 2006, available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_senate_committee_prints&docid=f:28640.pdf.

⁵² Letter from Reuben Jeffrey III, Chairman, CFTC, to Michigan Governor Jennifer Granholm, (Aug. 22, 2005); THE ROLE OF MARKET SPECULATION, *supra* note 18.

this week, they won't have to punch another ticket for the rest of this year,' (said Addison Armstrong, manager of exchange-traded markets for TFS Energy Futures)."⁵³

It is difficult for federal regulators to investigate market manipulation allegations even on the lightly-regulated exchanges like NYMEX let alone the unregulated OTC market. For example, as of August 2006, the Department of Justice (DOJ) is still investigating allegations of gasoline futures manipulation that occurred *on a single day in 2002*.⁵⁴ If it takes the DOJ four years to investigate a single day's worth of market manipulation, energy traders intent on price-gouging the public, clearly do not have much to fear.

That said, there have been some settlements for manipulation by large oil companies.⁵⁵ In January 2006, the CFTC issued a civil penalty against Shell Oil for "non-competitive transactions" in U.S. crude oil futures markets.⁵⁶ In March 2005, a Shell subsidiary agreed to pay \$4 million to settle allegations that it provided false information during a federal investigation into market manipulation.⁵⁷ Coral energy is a subsidiary of Shell.⁵⁸ In August 2004, the same Shell Oil subsidiary agreed to pay \$7.8 million to settle allegations of energy market manipulation.⁵⁹ In July 2004, Shell agreed to pay \$30 million

⁵³ Leah McGrath Goodman, "Oil Futures, Gasoline In NY End Sharply Lower," *Dow Jones* Sept. 2, 2005.

⁵⁴ John R. Wilke, et. al., *BP Woes Deepen with New Probe*, *WALL ST. J.*, Aug. 29, 2006 at C1.

⁵⁵ See also Tyson Slocum, *Hot Profits and Global Warming How Oil Companies Hurt Consumers and the Environment 11* (Sept. 2006), available at http://www.ftc.gov/bcp/workshops/energymarkets/background/slocum_oilgas.pdf. (last visited Apr. 24, 2007).

⁵⁶ Press Release, Commodity Futures Trading Comm'n, U.S. Commodity Futures Trading Commission Assesses Penalties of \$300,000 Against Shell-Related Companies and Trader in Settling Charges of Prearranging Crude Oil Trades, (Jan. 4, 2006) available at www.cftc.gov/opa/enf06/opa5150-06.htm (last visited Apr. 24, 2007).

⁵⁷ Press Release, Fed Energy Regulatory Comm'n, Commission Accepts Settlement Resolving Investigation of Coral Energy Resources, (Mar. 3, 2005), available at www.ferc.gov/press-room/press-releases/2005/2005-1/03-03-05.asp (last visited Apr. 24, 2007).

⁵⁸ www.coral-energy.com

⁵⁹ Order Approving Contested Settlement, 106 FERC ¶61,020 (2004) available at www.ferc.gov/whats-new/comm-meet/072804/E-60.pdf (last visited Apr. 24, 2007)

to settle allegations it manipulated natural gas prices.⁶⁰ In June 2006, the CFTC brought civil charges against BP for allegedly manipulating the entire U.S. propane market.⁶¹ In September 2003, BP agreed to pay NYMEX \$2.5 million to settle allegations that the company had engaged in improper crude oil trading, and in July 2003, BP agreed to pay \$3 million to settle allegations that it manipulated energy markets.⁶²

Many industry analysts agree that speculation is forcing oil and natural gas prices to increase.⁶³ For example, a May 2006 Citigroup report on the monthly average value of speculative positions in American commodity markets, found that the value of speculative positions in oil and natural gas stood at \$60 billion, and that “the hike in speculative positions has been a key driver for the latest surge in commodity prices.”⁶⁴

Natural gas markets are also harmed by these unregulated trading markets. Public Citizen representatives testified before Congress on this issue,⁶⁵ and four state attorneys general concluded in a March 2006 report that “natural gas commodity markets have exhibited erratic behavior and a massive increase in trading that contributes to both volatility and the upward trend in prices.”⁶⁶

In a report later dismissed in a New York Times article, the CFTC recently concluded that there was “no evidence of a link between price changes and MMT [managed money trader] positions” in

⁶⁰ Press Release, Commodity Futures Trading Comm’n, Coral Energy Pays \$30 Million to Settle U.S. Commodity Futures Trading Commission Charges of Attempted Manipulation and False Reporting, (Feb. 3, 2006), available at www.cftc.gov/opa/enf04/opa4964-04.htm (last visited Apr. 24, 2007)

⁶¹ Press Release, Commodity Futures Trading Comm’n U.S. Commodity Futures Trading Commission Charges BP Products North America, Inc. with Cornering the Propane Market and Manipulating the Price of Propane, (Jun. 28, 2006), available at www.cftc.gov/opa/enf06/opa5193-06.htm (last visited Apr. 26, 2007)

⁶² Order Approving Stipulation and Consent Agreement, 104 FERC ¶ 61,089 (2003) available at <http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=10414789> (last visited Apr. 24, 2007).

⁶³ See also Slocum, *Hot Profits*, *supra* note 53, at 10.

⁶⁴ See THE ROLE OF MARKET SPECULATION, *supra* note 18 at 20.

⁶⁵ *The Need for Stronger Regulation of U.S. Natural Gas Markets*, *supra* note 1.

⁶⁶ Mark N. Cooper, *The Role of Supply, Demand and Financial Commodity Markets in the Natural Gas Price Spiral*, 3 (*Prepared for*, Midwest Attorneys General Natural Gas Working Group (Illinois, Iowa, Missouri, Wisconsin, 2006) (Mar. 3, 2006), available at www.ago.mo.gov/pdf/NaturalGasReport.pdf (last visited Apr. 25, 2007).

the natural gas markets and “a significantly negative relationship between MMT positions and prices changes. . .in the crude oil market.”⁶⁷

But, the CFTC study is flawed for numerous reasons, including the fact that the role of hedge funds and other speculations on long-term trading were *not* included in the analysis. The *New York Times* reported that “many traders have scoffed at the studies, saying that they focused only on certain months, missing price run-ups.”⁶⁸

Public Citizen has long supported regulation of these exchanges, but the latest legislative effort to repeal the Commodity Futures Modernization Act of 2000 was rejected by the Senate by a vote of 55-44 in June 2003.⁶⁹ The lobbying influence of oil companies, financial firms and hedge funds played a key role in defeating the amendment. As the growth of hedge funds in energy markets continues, so does the industry’s presence on Capitol Hill. The Managed Funds Association (MFA), which represents hedge funds, and its political action committee has doled out \$300,900 in campaign contributions to members of congress since 2003.⁷⁰ (MFA—which recently put former Democratic Sen. John Breaux now a Patton Boggs lobbyist on its Board—operates out of the offices of the lobbying firm Smith Bucklin.) MFA hired at least nine former Congressional and Executive Branch officials, including: Patton Boggs’ Don Moorehead former GOP Chief Counsel to the Senate Finance Committee; the duo of Peter Rich former GOP House Energy Committee staffer and husband of a former senior counsel to the House Committee on Financial Services and Mitchell Feuer former Democratic staffer on the Senate Banking Committee; Sullivan & Cromwell’s Kenneth Raisler former general counsel of the CFTC; and Williams & Jensen’s cadre of lobbyists: David E. Franasiak, former Staff Director to the Tax Oversight Subcommittee of the U.S. House of Representatives Small Business Committee; J. Steven Hart, a former Reagan Administration official; Joel G. Oswald, former Senate Bank-

⁶⁷ Michael S. Haigh, et. al., *Price Dynamics, Price Discovery and Large Futures Trader Interactions in the Energy Complex*, U.S. Commodity Futures Trading Commission Apr. 28, 2005, 1 available at www.cftc.gov/files/opa/press05/opacftc-managed-money-trader-study.pdf, (last visited Apr. 26, 2007)

⁶⁸ Alexei Barrionuevo, *Energy Trading, Without a Certain “E,”* N.Y.TIMES, Jan. 15, 2006, §3 at 1.

⁶⁹ U.S. Senate Role Call Votes, 108th Congress, 1st Session, available at www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=108&session=1&vote=00218 (last visited Apr. 26, 2007).

⁷⁰ See generally Federal Election Campaign, Campaign Finance Reports and Data, www.fec.gov/finance/disclosure/srssea.shtml

ing Committee staffer working for Senator Michael B. Enzi (R-WY); and Christopher W. Hatcher, Legislative Director and Counsel for former Congressman Scott McInnis (R-CO).⁷¹

The lightly-regulated exchanges, like NYMEX, have their own revolving door army: NYMEX hires the lobbying services of Arent Fox, where at least three former Congressional staffers influence their former bosses: Harry Katrichis, former chief counsel to the US House of Representatives Committee on Small Business from 1995 to 2001; Lance Kotschwar, former General Counsel for the Senate Committee on Agriculture, Nutrition and Forestry; and Vicki J. Hicks, former senior Democratic Senate staffer and a senior USDA political appointee.⁷² Since 2003, NYMEX's Political Action Committee has made \$1.5 million in campaign contributions.⁷³

BP has been paying the Duberstein Group \$100,000 every six months to lobby Congress on "CFTC trading issues," with at least four lobbyists on the BP account: (Kenneth Duberstein, former chief of staff to President Reagan; Michael Berman, well connected with Democrats; Steven Champlin, staffer for former Rep. David Bonior; Henry Gandy, former legislative aide to President Bush; and Daniel Meyer, who serves on the board of the GOP-affiliated Congressional Institute.)⁷⁴

The CFTC has a troublesome streak of "revolving door" appointments and hiring which may further hamper the ability of the agency to effectively regulate the energy trading industry. In August 2004, CFTC chairman James Newsome left the commission to accept a \$1 million yearly salary as president of NYMEX, the world's largest energy futures marketplace.⁷⁵ Just weeks later, Scott Parsons, the CFTC's chief operating officer, resigned to become executive vice-president for government affairs at the Managed Funds Association.⁷⁶

⁷¹ See Slocum, *HOT PROFITS*, *supra* note 53, at 9.

⁷² Arent Fox, LLP Governmental Relations Team, <http://www.arentfox.com/practices/govrelations/index.cfm?fa=team> (follow the respective hyperlinks to each individual) (last visited Apr. 8, 2007).

⁷³ See *supra* note 71 and accompanying text.

⁷⁴ Secretary of Senate, Office of Public Records, The Duberstein, Group Inc., available at http://sopr.senate.gov/cgi-win/opr_gifviewer.exe?/2006/EH/000/113/000113383|5 (last visited Mar. 26, 2007).

⁷⁵ Leah McGrath Goodman, *CFTC's Newsome to Become Nymex President Aug 2*, Dow Jones Newswires, July 9, 2004.

⁷⁶ Press Release, Commodity Futures Trading Commission Announces Departure of Scott Parsons (Aug. 26, 2004), available at http://www.nymex.com/media/8k_070904.pdf. (last visited Apr. 26, 2007); see also Slocum, *HOT PROFITS* *supra* note 53, at 12.

Former CFTC Lead Prosecutor Anthony Mansfield, former Chief Trial Attorney and Counsel to the Director of the Division of Enforcement at the CFTC, left the Commission to join the DC firm Heller Ehrman, where he will work for Geoff Aronow—his old boss at CFTC.⁷⁷

Such prominent defects may hamper the CFTC's ability to protect consumers because former regulators now serve with industries being regulated. As a result, a revolving door moratorium should be established to limit CFTC decision makers from leaving the agency to go to entities under its regulatory jurisdiction for a set period of time.⁷⁸

II. Latest Trading Trick: Energy Infrastructure Affiliate Abuses

Energy traders like Goldman Sachs are investing and acquiring energy infrastructure assets because controlling pipelines and storage facilities affords their energy trading affiliates an “insider’s peek” into the physical movements of energy products unavailable to other energy traders. Armed with this non-public data, a company like Goldman Sachs could open lines of communication between the affiliates operating pipelines and the affiliates making large bets on energy futures markets. Without strong firewalls prohibiting such communications, consumers would be susceptible to price-gouging by energy trading affiliates.

For example, in January 2007, Highbridge Capital Management, a hedge fund controlled by JP Morgan Chase, bought a stake in an energy unit of Louis Dreyfus Group to expand its oil and natural gas trading.⁷⁹ Glenn Dubin, co-founder of Highbridge, said that owning physical energy assets like pipelines and storage facilities was crucial to investing in the business: “[t]hat gives you a very important information advantage. You’re not just screen-trading financial products.”⁸⁰

Indeed, such an “information advantage” played a key role in

⁷⁷ Press Release, Heller Ehrman, Anthony Mansfield Joins Heller Ehrman as Special Counsel in Washington, D.C. (Jan. 10, 2007).

⁷⁸ See also Slocum, *HOT PROFITS supra* note 53, at 12

⁷⁹ Saijel Kishan & Jenny Strasburg, *Highbridge Capital Buys Stake in Louis Dreyfus Unit*, Bloomberg, Jan. 8, 2007, available at Bloomberg.com www.bloomberg.com/apps/news?pid=20601014&sid=aBnQy1botdFo (last visited Apr. 26, 2007).

⁸⁰ *Id.*

allowing BP's energy traders to manipulate the entire U.S. propane market.⁸¹ In June 2006, the CFTC filed a civil complaint against BP, alleging that the company's energy trading affiliate used the company's huge control over transportation and storage to allow the energy trading affiliate to exploit information about energy moving through BP's infrastructure to manipulate the market.⁸²

BP's energy trading division, North America Gas & Power (NAGP), was actively communicating with the company's Natural Gas Liquids Business Unit (NGLBU), which handled the physical production, pipeline transportation and retail sales of propane.⁸³ Part of the civil complaint against BP details how the two divisions coordinated their manipulation strategy, which includes "assurance that [the] trading team has access to all information and optionality within [all of BP]. . . that can be used to increase chance of success [of market manipulation]. . . Implement weekly meetings with Marketing & Logistics to review trading positions and share opportunities."⁸⁴

This shows that energy traders were actively engaging the physical infrastructure affiliates in an effort to glean information helpful for market manipulation strategies. It is also important to note that BP's market manipulation strategy was extremely aggressive and blatant, and regulators were given a tip by an internal whistleblower.⁸⁵ A more subtle manipulation effort could easily evade detection by federal regulators, making it all the more important to establish firewalls between energy assets affiliates and energy trading affiliates to prevent any undue communication between the units.

The *Wall Street Journal* reported that the government investigation goes beyond manipulation of propane: "investigators are examining, among other things, whether BP used information about its

⁸¹ John Wilke & Chip Cummins, *U.S. Accuses BP of Manipulating Price of Propane*, WALL ST. J., Jun. 29, 2006 at A1.

⁸² Press Release, Commodity Futures Trading Commission, U.S. Commodity Futures Trading Commission Charges BP Products North America with Cornering the Propane Market and Manipulating Pricing of Propane (June. 28, 2006), available at <http://www.cftc.gov/opa/adv06/opawa26-06.htm>. (The lawsuit was filed in the United States District Court for the Northern District of Illinois, which sits in Chicago.); *Id.*

⁸³ See www.cftc.gov/files/enf/06orders/opa-bp-lessons-learned.pdf (last visited Apr. 26, 2007).

⁸⁴ *Id.*

⁸⁵ Tony Hopfinger, *One Crude Dude: With Big Oil reeling from the Prudhoe Bay shutdown, Chuck Hamel can finally say, 'I told you so'*, SEATTLE WEEKLY (Aug. 23, 2006), available at <http://www.seattleweekly.com/2006-08-23/news/one-crude-dude.php> (last visited Apr. 26, 2007).

own pipelines and storage tanks at a key oil-delivery point in Cushing, Okla., to influence crude-oil price benchmarks that are set each day and influence billions of dollars of transactions.”⁸⁶ CFTC staff have also recommended an enforcement action against Marathon Oil for crude-oil price manipulation.⁸⁷

Financial firms like hedge funds and investment banks that normally would not bother purchasing low-profit investments like oil and gasoline storage have been snapping up ownership or leasing rights or both to these facilities because of the wealth of information that controlling energy infrastructure assets provides to help one’s energy traders manipulate trading markets.⁸⁸ For example, according to *The Trader Monthly*, just one Morgan Stanley trader was able to earn as much as \$25 million and “helped the bank dominate the heating oil market by locking up New Jersey storage-tank farms adjacent to New York Harbor.”⁸⁹ The publication also revealed that legendary trader T. Boone Pickens earned as much as \$1.5 billion in 2005, for a rate of return exceeding 700 percent, which it is believed “is the largest one-year sum ever earned.”⁹⁰ In August 2006, Goldman Sachs, AIG and Carlyle/Riverstone announced the \$22 billion acquisition of Kinder Morgan, Inc., which controls 43,000 miles of crude oil, refined products and natural gas pipelines, in addition to 150 storage terminals.⁹¹

Prior to this huge purchase, Goldman Sachs had already assembled a long list of oil and gas investments. In 2005, Goldman Sachs and private equity firm Kelso & Co. bought the Coffeyville oil refinery in Kansas.⁹² In May 2004, Goldman Sachs spent \$413 mil-

⁸⁶ John R. Wilke, et. al. , *BP Woes Deepen with New Probe*, WALL ST. J. Aug. 29, 2006 at C1.

⁸⁷ Ann Davis, “U.S. Probes Crude-Price Manipulation,” *The Wall Street Journal*, May 10, 2007, Page C2.

⁸⁸ See e.g. Kathryn Kranhold, *GE and Canadian Fund to Buy Pipelines as Energy Interest Rises*, WALL ST. J., July 11, 2005, at B2.

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ Press Release, The Carlyle Group, Kinder Morgan, Inc. Enters into Agreement to Sell to Investor Group for \$107.50 Per Share (Aug. 28, 2006), available at <http://www.thecarlylegroup.com/eng/news/15-news3544.html> (last visited Apr. 26, 2007); Andrew Ross Sorkin & Jad Mouawad, *Gas Giant Gets Offer for Buyout*, N.Y. Times, May 30, 2006, at C1.

⁹² Press Release, Coffeyville Resources, Coffeyville Resources Acquired, Jack Lipinski Named CEO (July 12, 2006), available at <http://12.158.136.92/Pdfs/pressRoom01.pdf> (last visited Apr. 26, 2007).

lion to acquire royalty rights to more than 1,600 natural gas wells in Pennsylvania, West Virginia, Texas, Oklahoma and offshore Louisiana from Dominion Resources.⁹³ Goldman Sachs also owns a six percent stake in the 375-mile Iroquois natural gas pipeline, which runs from Northern New York through Connecticut to Long Island.⁹⁴ In December 2005, Goldman and Carlyle/Riverstone together invested \$500 million in Cobalt International Energy, a new oil exploration firm run by former Unocal executives.⁹⁵

In July 2005, GE and Caisse de dépôt et placement du Québec, who manages public and private pension and insurance funds, purchased Southern Star Central Gas Pipeline (Southern Star) from AIG for \$326 million plus the assumption of \$476 million in debt and preferred stock.⁹⁶ Southern Star runs for 6,000 miles through Texas, Oklahoma, Kansas, Missouri, Colorado, Nebraska, and Wyoming.⁹⁷ GE owns 60% and Caisse owns 40%.⁹⁸

Carlyle/Riverstone is a private equity fund. In April 2003, Carlyle/Riverstone teamed up with Madison Dearborn Partners to purchase a controlling stake in Williams Energy Partners, since renamed Magellan Midstream Partners, for \$1.08 billion.⁹⁹ Magellan Midstream went on to pay \$492.4 million for another refined product pipeline system from Shell Oil.¹⁰⁰ The Magellan refined products pipeline system begins in Texas and runs to Oklahoma, Colorado,

⁹³ Press Release, Dominion, Dominion Announces Volumetric Production Payment Transaction with Goldman Sachs (May 6, 2004), available at <http://www.dom.com/news/ep2004/pr0506.jsp> (last visited Apr. 26, 2007).

⁹⁴ Iroquois, *Pipeline Services System Map*, http://www.iroquois.com/new-Internet/igts/PipelineSvs/ps_sysmp.asp (last visited May 21, 2007).

⁹⁵ Press Release, The Carlyle Group, Carlyle/Riverstone and Goldman Sachs to invest \$500 million in Cobalt International Energy, a New Oil & Gas Exploration and Production Company (Dec. 1, 2005), available at <http://www.thecarlylegroup.com/eng/news/15-news3258.html> (last visited Apr. 26, 2007).

⁹⁶ Press Release, Southern Star Central Gas Pipeline, GE Commercial Finance and Caisse de Dépôt et placement du Québec Agree to Buy Major Midwestern Gas Pipeline from AIG Highstar Capital (July 11, 2005), available at www.sscgp.com/News/archive/2005/sold.htm (last visited Apr. 26, 2007).

⁹⁷ Southern Star Gas Central Pipeline, Inc. – About Us, <http://www.sscgp.com/aboutus/> (last visited Apr. 23, 2007).

⁹⁸Kranhold, *supra* note 84.

⁹⁹ Press Release, Williams Energy Partners Announces Buyer of General Partnership Interest (Apr. 21, 2003), available at <http://www.thecarlylegroup.com/eng/news/15-news2588.html> (last visited Apr. 23, 2007).

¹⁰⁰ *Magellan Mainstream Buys 2,000 Miles of Pipeline*, N.Y. TIMES Jun. 25, 2004, at C3.

Kansas, Missouri, Nebraska, Iowa, Illinois, Wisconsin, Minnesota, and North and South Dakota.¹⁰¹ In response to the Carlyle/Riverstone acquisition of Kinder Morgan, all the Federal Trade Commission required was that Carlyle/Riverstone's investment in Magellan be changed to passive.¹⁰² In May 2004, Carlyle/Riverstone became the general partner of Buckeye Partners, which owns an integrated pipeline system running through Missouri, Illinois, Indiana, Michigan, Ohio, Pennsylvania, New York, New Jersey, Connecticut and Massachusetts.¹⁰³ Carlyle/Riverstone is the general partner of SemGroup, which owns pipelines and storage facilities throughout the United State.¹⁰⁴ Carlyle/Riverstone owns Legend Natural Gas and Phoenix Exploration, both of which are domestic oil and gas producers.¹⁰⁵

In 2003, Morgan Stanley teamed up with Apache Corp to buy 26 oil and gas fields from Shell for \$500 million, of which Morgan Stanley put up \$300 million in exchange for a portion of the production over the next four years, which it used to supplement its energy trading desk.¹⁰⁶

Solutions

- Re-regulate energy trading markets by subjecting OTC electronic exchanges to full compliance under the Commodity Exchange Act and mandate that all

¹⁰¹ Magellan Mainstream Partners, LP, Assets,, <http://www.magellanlp.com/assets.asp> (last visited Apr. 27, 2007)

¹⁰² *FTC Challenges Acquisition of Interests in Kinder Morgan, Inc. by The Carlyle Group and Riverstone Holdings*, available at www.ftc.gov/opa/2007/01/kindermorgan.htm (last visited Apr. 23, 2007).

¹⁰³ Press Release, General Partner of Buckeye Partners, L.P., sold to Carlyle/Riverstone Global Energy and Power Fund II, L.P. (May 4, 2004), available at <http://www.thecarlylegroup.com/eng/news/15-news2783.html> (last visited Apr. 23, 2007); Press Release, Buckeye Partners, LP Acquires Midwest Pipelines and Terminals from Shell (Oct. 1, 2004), available at <http://www.thecarlylegroup.com/eng/news/15-news2884.html>. Recently, the refinery was sold yet again. <http://www.thecarlylegroup.com/eng/news/15-news3774.html> (last visited Apr. 23, 2007).

¹⁰⁴ The Carlyle Group, SemGroup L.P., <http://www.thecarlylegroup.com/eng/portfolio/portfolio15-3012.html> (last visited Apr. 27, 2007).

¹⁰⁵ The Carlyle Group, Legend Natural Gas, <http://www.thecarlylegroup.com/eng/industry/casestudy-770.html> (last visited Apr. 27, 2007).

¹⁰⁶ Paul Merolli, *Two Morgan Stanley M&A deals show bullish stance on gas*, *Natural Gas Week*, Volume 19; Issue 28, July 14, 2003.

OTC energy trades be subject to the CFTC's Large Trader reporting requirements. In addition, regulations must be strengthened over existing lightly-regulated exchanges like NYMEX. Senators Feinstein, Snowe, Levin and Cantwell have introduced S.577 in the 110th Congress which would address many of these issues.¹⁰⁷

- Impose legally-binding firewalls to limit energy traders from speculating on information gleaned from the company's energy infrastructure affiliates or other such insider information, while at the same time allowing legitimate hedging operations.¹⁰⁸
- Congress must authorize the FTC and DOJ to place greater emphasis on evaluating anti-competitive practices that arise out of the nexus between control over hard assets like energy infrastructure and a firm's energy trading operations. As outlined above, the increased presence of energy traders in owning physical assets has allowed energy and financial firms greater ability to have an "insiders peek" in movements of energy commodities, giving them a leg up in the futures markets. Incorporating energy trading operations into anti-trust analysis must become standard practice for federal regulatory and enforcement agencies to force more divestiture of assets in order to protect consumers from abuses.¹⁰⁹
- A revolving door moratorium must be established to limit CFTC decision makers from leaving the agency to go to entities under its regulatory jurisdic-

¹⁰⁷ See THE ROLE OF MARKET SPECULATION, *supra* note 18; Slocum, *supra* note 53, at 12.

¹⁰⁸ See Kishan & Strasburgm *supra* note 75; Wilke & Cummins, *supra* note 77; U.S. Commodity Futures Trading Commission Charges BP Products North America With Cornering the Propane Market and Manipulating the Pricing of Propane, *supra* note 78; Hot Profits, *supra* note 80; Hopfinger, *supra* note 81; Wilke, et. al., *supra* note 82; Kranhold, *supra* note 83; Slocum, Hot Profits, *supra* note 53, at 12.

¹⁰⁹ See Slocum, *supra* note 53, at 12.

tion for at least two years.¹¹⁰

III. Recent Mergers, Weak Anti-Trust Laws Threaten Consumers

In just the last few years, mergers between giant oil companies—such as Exxon and Mobil, Chevron and Texaco, Conoco and Phillips—have resulted in just a few companies controlling a significant amount of America's gasoline, squelching competition.¹¹¹ In 1993, the largest five oil refiners, Chevron, Exxon, Amoco, Texaco and Mobil, Controlled one-third of the American market, while the largest 10 had 55.6 percent.¹¹² By 2005, as a result of all the mergers, the largest five now (ConocoPhillips, Valero, ExxonMobil, Shell and BP) control 55 percent of the market, and the largest 10 dominate 81.4 percent.¹¹³

In addition, legal decisions which favor a rule of reason analysis rather than a per se analysis of alleged anticompetitive conduct, continue to erode anti-trust laws thereby exposing consumers to uncompetitive markets.¹¹⁴

Although the United States is the third largest (Saudi Arabia and Russia are the largest two) oil producing nation in the world—producing more oil than Iran, Kuwait and Qatar *combined*¹¹⁵—the United States consumes one out of every four barrels used in the world every day, forcing the United States to import 60 percent of its

¹¹⁰ See 15 U.S.C. § 78m(h), *supra* note 49; Letter From Reuben Jeffrey III, Chairman, CFTC, to Michigan Governor Jennifer Granholm, *supra* note 50; Role of Market Speculation, *supra* note 50; Goodman, *supra* note 51; Wilke, et. al., *supra* note 52; Slocum, *supra* note 53; Commodity Futures Trading Comm'n, *supra* note 54; Fed. Energy Reg. Comm'n, *supra* note 55; Fed. Energy Reg. Comm., *supra* note 56; Commodity Futures Trading Comm'n, *supra* note 57; CFTC Announces Departure of Scott Parsons, *supra* note 72; Anthony Mansfield Joins Heller Ehrman As Special Counsel in Washington, D.C., *supra* note 73; Slocum, *supra* note 53, at 12; Kishan & Strasburg, *supra* note 75..

¹¹¹ See *New Jersey's High Gasoline Prices*, *supra* note 1.

¹¹² Data compiled by Public Citizen from Energy Information Administration data.

¹¹³ Public Citizen calculations from Energy Information Administration data.

¹¹⁴ See, e.g., *State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997); *Lucas v. Citizens Comm. Co.*, 409 F.Supp.2d 1206, 1219 (D. Haw. 2005); *United States v. Visa U.S.A., Inc.*, 344 F.3d 229 (2nd Cir. 2003); *Mitchael v. Intracorp, Inc.*, 179 F.3d 847 (10th Cir. 1999).

¹¹⁵ Top World Oil Exporters and Producers, *available at*, www.eia.doe.gov/emeu/cabs/topworldtables1_2.html (last visited Apr. 23, 2007)

oil and gasoline.¹¹⁶ In all, the U.S. uses more oil than the next five biggest oil consumers, China, Japan, Russia, Germany and India, together.¹¹⁷

Sixty percent of the oil consumed in America is used as fuel for cars and trucks.¹¹⁸ Nine percent is for residential home heating, and the remainder is largely used for various industrial and agricultural processes.¹¹⁹ Only 1.4 percent of the oil consumed is for fueling electric power).¹²⁰

Persian Gulf OPEC nations supply 11.2 percent of America's oil and gasoline.¹²¹ Other OPEC nations—such as Indonesia, Nigeria and Venezuela—supply 15.6 percent, and non-OPEC nations such as Canada, Mexico, Norway and England provide the U.S. with 39.1 percent of its oil and gasoline needs.¹²² 34.1 percent of America's oil is drilled within the country.¹²³

According to the U.S. Government Accountability Office, over 2,600 mergers in the United States petroleum industry have been approved since the 1990s.¹²⁴ Over the last few years, mergers between giant oil companies—such as Exxon and Mobil, Chevron and Texaco, Conoco and Phillips—resulted in only a few companies controlling a significant amount of America's gasoline, squelching competition.¹²⁵ In August 2005, ChevronTexaco acquired Unocal,¹²⁶

¹¹⁶ U.S. Gen. Accounting Office, Energy Markets: Effects of Mergers and Market Concentration in the United States Petroleum Industry, *available at* <http://www.gao.gov/new.items/d0496.pdf> [hereinafter GAO Effects of Mergers] (last visited Apr. 27, 2007)

¹¹⁷ Top World Oil Exporters and Producers, *available at* www.eia.doe.gov/emeu/cabs/topworldtables3_4.html (last visited Apr. 23, 2007)

¹¹⁸ Adjusted Sales of Distillate Fuel Oil by End Use in the U.S., 2005, *available at*, http://tonto.eia.doe.gov/dnav/pet/pet_cons_821dsta_dcu_nus_a.htm (last visited Apr. 23, 2007)

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ U.S. Total Crude Oil and Products Imports, *available at* http://tonto.eia.doe.gov/dnav/pet/pet_move_impcus_a2_nus_ep00_im0_mbbldpd_a.htm (last visited Mar. 15, 2007).

¹²² *Id.*

¹²³ *Id.*

¹²⁴ GAO Effects of Mergers, *supra* note 108, at 4, 7

¹²⁵ *Id.* at 7-8.

¹²⁶ Press Release, ChevronTexaco Celebrates 2004 as a Year of Great Accomplishment (Apr. 27, 2005), *available at* <http://www.chevron.com/news/press/>

ConocoPhillips acquired Burlington Resources in December 2005;¹²⁷ and in June 2006, Anadarko Petroleum announced it was simultaneously acquiring Kerr-McGee and Western Gas Resources.¹²⁸

Consumers are paying more at the pump than they would if they had access to competitive markets, and the five oil giants are reaping the largest profits in history. Since 2001, the five largest oil companies operating in America recorded \$435 billion in profits. While America's tremendous appetite for gasoline undoubtedly plays a role, uncompetitive practices by oil corporations are (a) cause—more so than OPEC or environmental laws—of high gasoline prices around the country.¹²⁹

High oil prices detrimentally impact the economy and national security. Imported oil represents one-third of America's trade deficit,¹³⁰ slows economic growth, adds to inflationary pressures and creates financial hardship for families and businesses. America's addiction to oil enriches not only oil companies, but non-democratic nations that are often hostile to U.S. interests.¹³¹ In its' frenzied pursuit to secure sources of oil abroad, the United States often prioritize oil company rights over human rights, as demonstrated in the deferential treatment the Bush Administration shows towards Kazakhstan despite that country's poor human rights record.¹³²

The consolidation of downstream assets—particularly refineries—plays a big role in determining the price of a gallon of gas.¹³³ Recent mergers have resulted in dangerously concentrated levels of ownership over U.S. oil refining.¹³⁴ A recent government study re-

2005/2005-04-27.asp (last visited Apr. 27, 2007).

¹²⁷ Press Release, ConocoPhillips to Acquire Burlington Resources in \$35.6 Billion Transaction (Dec. 12, 2005), available at http://www.conocophillips.com/NR/rdonlyres/86E7B7A6-B953-4D0D-9B45-E4F1016DD8FD/0/cop_burlingtonpressrelease.pdf (last visited Apr. 27, 2007)

¹²⁸ *World Business Briefing Americas: Canada: Anadarko Sells Energy Assets*, N.Y. TIMES, Sept. 16, 2006, at C4.

¹²⁹ GAO EFFECTS OF MERGERS, *supra* note 108 at 6

¹³⁰ See generally Bureau of Economic Affairs, Monthly Estimates of Trade in Goods and Services, available at www.bea.gov/bea/di/home/trade.htm (last visited May 22, 2007).

¹³¹ See, e.g., Information available at <http://hrw.org/doc?t=europe&c=kazakh> (linking to articles reporting human rights violations in Kazakhstan) (last visited Apr. 23, 2007).

¹³² *Id.*

¹³³ GAO Effects of Mergers, *supra* note 108 at 7

¹³⁴ *Id.* (discussing increased concentration in industry).

vealed that the “source of potential market power in the wholesale gasoline market is at the refining level because the refinery market is imperfectly competitive and refiners essentially control gasoline sales at the wholesale level.”¹³⁵

In 1993, the five largest U.S. oil refining companies controlled 34.5 percent of domestic oil refinery capacity; the top ten companies controlled 55.6 percent.¹³⁶ By 2005, the top five—ConocoPhillips, Valero, ExxonMobil, Shell and BP—controlled 55 percent and the top ten refiners controlled 81.4 percent.¹³⁷ As a result of all of these recent mergers, the largest five oil refiners today control as much capacity as the largest ten did a decade ago.

The industry has plenty of incentives to intentionally keep refining markets tight. For example, ExxonMobil’s new CEO told *The Wall Street Journal* that even though American fuel consumption will continue growing for the next decade, his company has no plans to build new refineries:

Exxon Mobil Corp. says it believes that, by 2030, hybrid gasoline-and-electric cars and light trucks will account for nearly 30% of new-vehicle sales in the U.S. and Canada. That surge is part of a broader shift toward fuel efficiency that Exxon thinks will cause fuel consumption by North American cars and light trucks to peak around 2020—and then start to fall. “For that reason, we wouldn’t build a grassroots refinery” in the U.S., Rex Tillerson, Exxon’s chairman and chief executive, said in a recent interview. Exxon has continued to expand the capacity of its existing refineries. But building a new refinery from scratch, Exxon believes, would be bad for long-term business.¹³⁸

Margins for U.S. oil refiners have been at record highs. In 1999, U.S. oil refiners enjoyed an 18.9 cent margin for every gallon refined from crude oil.¹³⁹ By 2005, they posted a 48.8 cent margin

¹³⁵ *Energy Markets: Mergers and Other Factors that Affect the U.S. Refining Industry: Before the Subcomm. on Energy and Air Quality, Comm. on Energy and Com.* (2004) (statement of Jim Wells, Director, Natural Resources and environment) available at <http://www.gao.gov/new.items/d04982t.pdf> (last visited Apr. 22, 2007),

¹³⁶ Public Citizen calculations of Energy Information Administration data.

¹³⁷ *Id.*

¹³⁸ Jeffrey Ball, *As Gasoline Prices Soar, Americans Resist Major Cuts in Consumption*, WALL ST. J., May 1, 2006 at A1.

¹³⁹ 2005 EIA ANN. ENERGY REV. 175 available at http://www.eia.doe.gov/emeu/aer/pdf/pages/sec5_53.pdf (last visited Apr. 22, 2007).

for every gallon of gasoline refined, a 158 percent jump.¹⁴⁰ That forced *The Wall Street Journal* to conclude that “the U.S. market is especially lucrative, sometimes earning its refiners \$20 or more on every barrel of crude oil they refine.”¹⁴¹

Indeed, BP’s most recent financial report shows that refining profit margins in the United States operations are more than double the margins in other countries.¹⁴² In 2006, BP earned \$9.14 for every barrel they refined in the Midwest, \$12 per barrel in the Gulf Coast and \$14.84 per barrel on the West Coast.¹⁴³ In comparison, the returns from BP’s English operations were \$3.92 per barrel and in Singapore, operations were \$4.22 per barrel.¹⁴⁴

Concentration of refinery markets has been compounded by consolidation in gasoline marketing. Refiners get gasoline to the market by distributing their product through terminals, where wholesale distributors, or jobbers, then deliver to retail gas stations.¹⁴⁵ The number of terminals available to jobbers in the United States was cut by half from 1982 to 1997, leaving retailers with fewer options if one terminal raises prices.¹⁴⁶

As a result of this strategy of keeping refining capacity tight, energy traders in New York are pushing the price of gasoline higher, and then trading the price of crude oil up to follow gasoline:

“Last time, Mother Nature intervened in the market [in the form of Hurricane Katrina],” [Larry] Goldstein [president of New York-based Petroleum Industry Research Foundation] said. “This time, prices are being driven by market forces,” *with gasoline pulling crude and other forms of fuel higher*, he says.¹⁴⁷

¹⁴⁰ *Id.*

¹⁴¹ Steve LeVine & Patrick Barta, *Giant New Oil Refinery in India Shows Forces Roiling Industry*, WALL ST. J. Aug. 29, 2006, at A1

¹⁴² BP, Group Results Fourth Quarter and Full Year 2006 Unaudited, at 8 (Feb. 6, 2007), available at http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/downloads/B/bp_fourth_quarter_and_full_year_2006_results.pdf (last visited Apr. 23, 2007).

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ FED TRADE COMMISSION BUREAU OF ECONOMICS, THE PETROLEUM INDUSTRY: MERGERS, STRUCTURAL CHANGE AND ANTITRUST ENFORCEMENT, AN FTC STAFF STUDY 39 (Aug. 2004), available at <http://www.ftc.gov/os/2004/08/040813mergersinpetrolberpt.pdf> (last visited Apr. 22, 2007).

¹⁴⁶ *Id.* at Table 9-1.

¹⁴⁷ Bhushan Bahree *Oil Prices Show No Sign of Slowing*, WALL ST. J., Apr 10,

Since gasoline futures are a more localized market than crude oil, it is easier for oil companies, hedge funds and investment banks to manipulate gasoline markets. Now that crude oil trading often follows the gasoline markets, the ability of these traders to exploit America's underregulated futures markets raises concerns that consumers are being price-gouged.

High domestic inventories are not suppressing prices.¹⁴⁸ In April 2006, U.S. commercial inventories of crude oil surpassed 347 million barrels—the highest level since May 1998.¹⁴⁹ Despite this record domestic surplus, energy traders continue to push the price of crude oil up.

The U.S. Federal Trade Commission found evidence of anti-competitive practices in its March 2001 *Midwest Gasoline Price Investigation*:

“An executive of [one] company made clear that he would rather sell less gasoline and earn a higher margin on each gallon sold than sell more gasoline and earn a lower margin. Another employee of this firm raised concerns about oversupplying the market and thereby reducing the high market prices. A decision to limit supply does not violate the antitrust laws, absent some agreement among firms. Firms that withheld or delayed shipping additional supply in the face of a price spike did not violate the antitrust laws. In each instance, the firms chose strategies they thought would maximize their profits.”¹⁵⁰

Although federal investigators found ample evidence of oil companies intentionally withholding supplies from the market in the summer of 2000, the government has not taken any action to prevent recurrence. S.2557, introduced by Senator Arlen Specter (R-Penn.),¹⁵¹ and its House companion HR 5279 introduced by Representative John Conyers,¹⁵² would amend the Clayton Act to make it unlawful for oil companies to engage in unilateral withholding.¹⁵³

2006 at A8 (emphasis in original).

¹⁴⁸ Table Energy Info. Admin. U.S. Crude Oil Ending Stocks Excluding SPR (Thousands of Barrels), Mar. 1, 2007, available at <http://tonto.eia.doe.gov/dnav/pet/hist/mcestus1m.htm> (Apr. 22, 2007).

¹⁴⁹ *Id.*

¹⁵⁰ FINAL REP. OF THE FED. TRADE COMMISSION, MIDWEST GASOLINE PRICE INVESTIGATION, Mar. 29, 2001 available at <http://www.ftc.gov/os/2001/03/mwgasrpt.htm> (last visited Apr. 22, 2007)

¹⁵¹ Oil and Gas Antitrust Act of 2006, S. 2557, 109th Cong. (2006).

¹⁵² H.R. 5279, 109th Cong. §2 (2006).

¹⁵³ See S. 2557, 109th Cong. (2006) and H.R. 5279, 109th Cong. § 2 (2006).

But neither of these bills received a hearing in the 109th Congress.¹⁵⁴

A congressional investigation in the late 1990s uncovered internal memos written by major oil companies operating in the U.S. which discussed their successful strategies to maximize profits by forcing independent refineries out of business, resulting in tighter refinery capacity. From 1995-2005, 97 percent of the nearly 929,000 barrels of oil per day of capacity that has been shut down were owned by smaller, independent refiners.¹⁵⁵

IV. The FTC is Not Adequately Protecting Consumers

The Federal Trade Commission has contributed to the problem by allowing too many mergers and taking a stance too permissive to anti-competitive practices. This is evidenced by the conclusions in its most recent investigation for example, the FTC found evidence of price-gouging by oil companies but explained it away as profit maximization strategies and opposing federal price-gouging statutes.¹⁵⁶ This stands in stark contrast to the May 2004 conclusions reached by a U.S. Government Accountability Office report¹⁵⁷ which found that recent mergers in the oil industry have directly led to higher prices. It is important to note that this GAO report severely *underestimates* the impact mergers have on prices because their price analysis *stopped* in 2000—before the mergers that created Chevron-Texaco-Unocal, ConocoPhillips-Burlington Resources, and Valero-Ultramar/Diamond Shamrock-Premcor.¹⁵⁸

The FTC consistently allows refining capacity to be con-

¹⁵⁴ See Status S. 2557, 109th Cong. (2006) <http://thomas.loc.gov/cgi-bin/bdquery/z?d109:SN02557:@@@X> (indicating last action on S. 2557 was placement on the legislative calendar) (last visited Apr. 22, 2007); and Status H.R. 5279, 109th Cong. (2006) available at <http://thomas.loc.gov/cgi-bin/bdquery/?d109:HR05279:@@@X> (indicating that last major action on HR 5279 was a referral to committee in May 2006) (last visited Apr. 22, 2007).

¹⁵⁵ Energy Information Administration Form EIA-820, *Annual Refinery Report*.

¹⁵⁶ See FED. TRADE COMMISSION, INVESTIGATION OF GASOLINE PRICE MANIPULATION AND POST-KATRINA GASOLINE PRICE INCREASES, (Spring 2006), available at www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf (last visited Apr. 22, 2007)

¹⁵⁷ See GAO EFFECTS OF MERGERS, *supra* note 89 at 108.

¹⁵⁸ See *supra* notes 100-102 and accompanying text; See also Press Release, Valero Energy Corp. Valero to Acquire Premcor in \$8 Billion Transaction (Apr. 25, 2005), available at http://www.valero.com/NewsRoom/News+Releases/NR_20050425.htm. (last visited Apr. 23, 2007).

trolled by fewer hands, allowing companies to keep most of their refining assets when they merge, as a recent overview of FTC-approved mergers demonstrates.

The FTC conditioned approval of the August 2002 ConocoPhillips merger on the company selling two of its refineries—representing less than four percent of its capacity.¹⁵⁹ Thus, Phillips sold a Utah refinery, and Conoco sold a Colorado refinery.¹⁶⁰ Even with this forced sale, ConocoPhillips remains the third largest domestic refiner, controlling refineries with a capacity of more than 2.2 million barrels of oil per day, or 13 percent of America's entire capacity.¹⁶¹ Curiously, after forcing the sale of two refineries, the FTC allowed ConocoPhillips to purchase Premcor's 300,000 barrels/day Illinois refinery in 2003¹⁶²

As a condition of the 1999 merger creating ExxonMobil, Exxon had to sell some of its gas retail stations in the Northeastern United States as well as an oil refinery in California.¹⁶³ Valero Energy, the nation's fifth largest owner of oil refineries, purchased the assets Exxon sold.¹⁶⁴ The inadequacy of the forced divestiture mandated by the FTC was compounded by the fact that the assets were simply transferred to another large oil company, ensuring that the consolidation of the largest companies remained high.

The sale of the Golden Eagle refinery was ordered by the FTC as a condition of Valero's purchase of Ultramar Diamond Shamrock in 2001.¹⁶⁵ Just as with ExxonMobil and ChevronTexaco, Valero sold the refinery along with 70 retail gas stations to another large

¹⁵⁹ Public Citizen calculations of Energy Information Administration data.

¹⁶⁰ *Id.*

¹⁶¹ Public Citizen calculations of Energy Information Administration data.

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www.conocophillips.com/newsroom/news_releases/2003releases/073103_woodriver.htm

¹⁶³ Press Release, Fed. Trade Commission, Exxon Mobile Agrees to Largest FTC Divestiture Ever in Order to Settle FTC Antitrust Charges; Settlement requires Extensive Restructuring and Prevents Merger of Significant Competing U.S. Assets (Nov. 30, 1999), available at <http://www.ftc.gov/opa/1999/11/exxonmobil.htm> (last visited Apr. 22, 2007); See also GAO EFFECTS OF MERGERS supra note 89, at 64 n.21.

¹⁶⁴ Alan Doyle, Valero turns Benica over to an Old Hand, (Sept. 22, 2002), www.bizjournals.com/eastbay/stories/2002/09/30/story3.html.

¹⁶⁵ Press Release, Fed. Trade Commission, Resolving Anticompetitive Concerns, FTC Consent Order would Allow Merger of Valero Energy and Ultramar (Dec. 18, 2001), available at <http://www.ftc.gov/opa/2001/12/valero.htm> (last visited Apr. 22, 2007).

company, Tesoro.¹⁶⁶ But while the FTC forced Valero to sell one of its four California refineries, the agency allowed the company to purchase Orion Refining's only refinery in July 2003,¹⁶⁷ and then approved Valero's purchase of the U.S. oil refinery company Premcor.¹⁶⁸ The acquisition of Orion's Louisiana refinery and the Premcor refinery defeats the original intent of the FTC's order for Valero to divest one of its California refineries.

V. Rule of Reason versus Per Se Antitrust Analysis

A recent decision of the Supreme Court of the United States continued an unfortunate trend of relying on the rule of reason rather than a per se analysis of alleged anticompetitive conduct.¹⁶⁹ Per se offenses are those that are illegal on their face, with no economic justification.¹⁷⁰ All per se offences are violations of Section 1 of the Sherman Act. As the Supreme Court has found:

. . .there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.¹⁷¹

Examples of per se antitrust violations include: horizontal and vertical price fixing, bid rigging, territorial allocation and tying arrangements.

A rule of reason standard, on the other hand, is one where the activity is judged in context and the reasonableness is considered.¹⁷² Therefore, an action that otherwise would be unlawful could be

¹⁶⁶ Press Release, Valero Energy Corporation, Valero Completes Sale of Golden Eagle Refinery and Related Assets (May 17, 2002), available at http://www.valero.com/NewsRoom/News+Releases/NR_2002-05-17.htm (last visited Apr. 24, 2007)

¹⁶⁷ Press Release, Valero Energy Corporation, Acquisition of Orion Refinery to Proceed (Jun. 27, 2003), available at http://www.valero.com/NewsRoom/News+Releases/NR_2003-06-27.htm (last visited Apr. 24, 2007)

¹⁶⁸ Press Release, Valero to Acquire Premcor in \$8 Billion Transaction (Apr. 25, 2005), available at http://www.valero.com/NewsRoom/News+Releases/NR_20050425.htm (last visited Apr. 18, 2007).

¹⁶⁹ *Texaco v. Dagher*, 547 U.S. 1, 4 (2006)

¹⁷⁰ *Id.* at 3 (*quoting* National Soc'y of Prof'l En'rs v. U.S., 435 U.S. 679, 692 (1978) and *State Oil*, 522 U.S. at 10.)

¹⁷¹ *N. Pac. R.R. Co. v. U.S.*, 356 US 1, 5 (1957).

¹⁷² *Texaco*, 547 U.S. at 3 (*citing* *State Oil*, 522 U.S. at 10.)

judged to be in compliance with the Sherman Act if the conduct surrounding the unlawful activity is deemed to justify it.¹⁷³

Clearly then, courts that favor a rule of reason standard over per se condone otherwise uncompetitive actions. The February 2006 Supreme Court case, *Texaco v. Dagher*, where two competitors, Shell and Texaco formed a joint venture, Equilon, to unilaterally set prices that the venture charged customers, is an example.¹⁷⁴ As an amicus brief filed by the American Antitrust Institute explained:

Evidence suggests that Shell and Texaco officials had deliberately refrained from discussing brand pricing prior to the formation of the venture "because of anti-trust concerns." . . . [o]f greatest significance, Respondents offered evidence that Equilon sharply raised the price of its gasoline, at a time when crude oil prices were stable or declining. . . Shell and Texaco were not seeking to create a more efficient competitor in a competitive marketplace, but to profit by lessening competition between the two former rivals."¹⁷⁵

But because the Court relied on a rule of reason analysis, this anti-competitive practice was deemed to be in compliance with the Sherman Act.

VI. Natural Markets In Need of Stronger Regulations, Too¹⁷⁶

While the CFTC regulates the natural gas futures markets, the Federal Energy Regulatory Commission is in charge of regulating other aspects of natural gas markets. The FERC has a legal mandate to ensure that electricity prices under its jurisdiction are "just and reasonable,"¹⁷⁷ but, there is no such "fair price" standard for natural gas. As natural gas continues to have a bigger impact on the U.S. econ-

¹⁷³ *See Id.*

¹⁷⁴ *Id.* at 4. See Peter Carstensen, *Using Dagher to Refine the Analysis of Mergers and Joint Ventures in the Petroleum Industry and Beyond*, 19 LOY CONSUMER L.REV. 447 (2007) for a full discussion of *Dagher* and its implications.

¹⁷⁵ Brief of Amicus Curiae American Antitrust Institute at 3, 6, *Texaco v. Dagher*, 547 U.S. 1 (2006), available at www.antitrustinstitute.org/archives/files/465.pdf (last visited Apr. 24, 2007).

¹⁷⁶ *See generally* Consumer Concerns with Natural Gas, *supra* note 1; Need for Stronger Regulation of U.S. Gas Markets, *supra* note 1.

¹⁷⁷ 16 U.S.C.A 824a-3 (2005).

omy—not to mention setting the de facto price of electricity due to its use as fuel for power—legislation establishing a “just and reasonable” standard for all natural gas production should be considered. Although FERC does regulate the transportation of natural gas through pipelines, and can enforce “just and reasonable” rates, this is only a small portion of what ultimately determines the price of natural gas.¹⁷⁸

The largest portion, production, was deregulated by two Congressional acts. First, the Natural Gas Policy Act of 1978 phased-in the removal of most wellhead price controls.¹⁷⁹ Second, the 1989 Wellhead Decontrol Act, ended the last remaining price controls.¹⁸⁰

The solution is to extend FERC regulation over wellhead prices, which would include subjecting producers to “just and reasonable” standards—just as FERC has the current authority to subject electricity producers to “just and reasonable” standards.¹⁸¹

Indeed, the National Association of Gas Consumers, a coalition of municipal gas systems, filed a complaint with FERC in 2001 arguing that skyrocketing natural gas prices were not “just and reasonable,” and requested that FERC either: a) set an emergency nationwide price ceiling; or b) initiate an investigation into whether or not refunds could be ordered for those prices above the “just and reasonable” standard.¹⁸²

FERC dismissed the complaint noting that: “[a] number of parties contend the Commission should also take action to limit the prices at which natural gas can be sold. However, under the Wellhead Decontrol Act, and the Commission regulations implementing that Act, natural gas prices have been effectively decontrolled. Therefore, the Commission declines to take the requested action on the instant complaints.”¹⁸³

Amending the Natural Gas Act¹⁸⁴ to expand FERC’s “just and reasonable” jurisdiction over wellhead prices would help correct this error. Changing this statute to include “the production or gathering of natural gas” would help hold natural gas producers accountable.

¹⁷⁸ 15 USC § 717c

¹⁷⁹ Natural Gas Policy Act of 1978, Pub. L. 95-621, codified as 15 U.S.C. 3301, et. seq.

¹⁸⁰ Natural Gas Wellhead Decontrol Act of 1989, Pub. L. 101-60.

¹⁸¹ 16 U.S.C.A §844a-3 (2005).

¹⁸² Docket RP01-223, available at <http://elibrary.ferc.gov/>

¹⁸³ *Id.*

¹⁸⁴ 15 USC § 717 (2005).

The United States Court of Appeals for the Ninth Circuit recently ruled that the FERC has broader power than it currently exercises to force energy companies to provide refunds to consumers for overcharging.¹⁸⁵ The ability of FERC to order such refunds, however, is contingent upon the existence of the “just and reasonable” standard enshrined in the Federal Power Act.¹⁸⁶ Without such a standard for natural gas, consumers are left unprotected.¹⁸⁷

Solutions

- Strengthen antitrust laws by empowering the Federal Trade Commission to crack down on unilateral withholding and other anti-competitive actions by oil companies.¹⁸⁸
- Congress must legislate stronger merger guidelines to prevent the kind of consolidation permitted by the FTC over the last few years, including mandating that cases brought under the Sherman Act must use the per se standard when evaluating violations of the Act.¹⁸⁹
- The Department of Energy should implement a Strategic Refinery Reserve (SRR), to complement the successful Strategic Petroleum Reserve, such as the one proposed in S.1979. Refined products produced at the facility could be placed in reserve to be released in times of natural disasters or price spikes. An SRR would prove useful in diminishing the ability of oil companies to engage in unilateral withholding, as the SRR could be used to release supplies to satisfy the needs of consumers, thereby lowering prices.¹⁹⁰

¹⁸⁵ Pub. Utilities Comm’n of the State of Cal. v. Pub. Utilities Comm’n of Nev., 462 F.3d 1029, 1060-61 (9th Cir. 2006).

¹⁸⁶ *Id.* at 1060.

¹⁸⁷ *See Id.*

¹⁸⁸ *See supra* notes 141-145.

¹⁸⁹ *See supra* Section IV

¹⁹⁰ *See supra* notes 141-45.

- Reregulate natural gas markets by granting the Federal Energy Regulatory Commission “just and reasonable” rate authority over natural gas wellhead prices.¹⁹¹

VII. Taxing Oil Company Profits

Apologists for record oil company profits argue that the companies need and deserve record windfalls to provide the necessary market incentive to invest more money into increased energy production.

Public Citizen’s analysis of oil company profits and their investments show that oil companies spend unprecedented sums on benefits for their shareholders in the form of stock buybacks and dividend payments and do not adequately invest in sustainable energy that is necessary to end America’s addiction to oil.¹⁹² Since January 2005, the top five oil companies have spent \$153 billion buying back stock and paying out dividends—more than the companies spent on capital investment.¹⁹³ This not only represents a huge transfer of wealth from consumers to oil company investors, but shows that oil companies are squandering opportunities to use their record profits to make investments that will end America’s addiction to oil.

With nearly \$1 trillion of combined assets tied up in extracting, refining and marketing petroleum and natural gas, the five big oil companies’ business models are designed to squeeze every last cent of profit out of their monopoly control over fossil fuels. They simply will not make significant investments in anything else until their monopoly control over oil is spent.

Additionally, the monopoly control translates into unprecedented profits. When communicating to the general public and lawmakers, oil companies downplay these record earnings by calculating profits differently than they do when they speak to Wall Street and shareholders. Conversing with lawmakers and the general public, the oil industry highlights the small profit margins, typically around 8 to 10 percent, that measuring net income as a share of total revenues produces.

But when ExxonMobil and other energy companies talk to investors and Wall Street, they do not highlight the small profit margins which measure net income as a share of the total revenue. For exam-

¹⁹¹ See *supra* notes 164 -170.

¹⁹² See Slocum, Hot Profits, *supra* note 53 at 13.

¹⁹³ *Id.*

ple, an excerpt from the ExxonMobil's 2005 annual report states: "ExxonMobil believes that return on average capital employed (ROCE) is the most relevant metric for measuring financial performance in a capital-intensive business such as" petroleum.¹⁹⁴

ExxonMobil's 2006 earning report shows that that the company's global operations enjoyed a 32 percent rate of return on average capital employed.¹⁹⁵ ChevronTexaco reported a 23 percent rate of return on average capital employed in 2006.¹⁹⁶

With oil companies not taking action to protect America's middle- and low-income families from the high-energy prices that fuel their profits, oil industry subsidies should be repealed with the proceeds invested in renewables, alternative fuels, energy efficiency and mass transit. Indeed, HR 6, which passed the House on January 18, 2007 repeals \$14 billion in oil company subsidies over the next decade and dedicates the money to a new "Strategic Energy Efficiency and Renewables Reserve."¹⁹⁷

Naysayers argue that increasing taxes on oil companies or enacting a Windfall Profits Tax did not work the last time it was tried.¹⁹⁸ The Windfall Profits Tax of 1980-88 was ineffective not because of the tax itself, but because oil prices fell shortly after enactment of the tax due to global events unrelated to U.S. tax policy. Congress enacted the Windfall Profits Tax in 1980 after U.S. oil company profits surged following the Iranian Revolution and the resulting Iran-Iraq war, which caused oil prices to increase from \$14/barrel in 1979 to \$35/barrel by January 1981. But after 1981, crude oil prices steadily decreased until completely bottoming out in 1986-87 as demand fell and as other oil producing countries increased their output. As the value of the commodity subject to the tax fell, the effectiveness of the tax diminished.

But that was then. *The Wall Street Journal* recently concluded that "a crash looks unlikely now, both because supplies remain tight and because of the large volumes of money that investors

¹⁹⁴ ExxonMobile 2005 Summary Annual Report 19, available at www.exxonmobil.com/corporate/files/corporate/sar_2005.pdf.

¹⁹⁵ Exxon Mobil Corp. Form 10-K at 30 (2006), www.sec.gov/Archives/edgar/data/34088/000119312507042435/d10k.htm

¹⁹⁶ Press Release, Chevron Reports Third Quarter Net Income of \$5 Billion, up 40% from \$3.6 Billion in Third Quarter 2005, 2 (Oct. 27, 2006), available at http://media.corporate-ir.net/media_files/irol/13/130102/IRhome/3Q_Release.pdf

¹⁹⁷ H.R. 6, 110th Cong. Sec.1 (2007), see also www.citizen.org/pressroom/release.cfm?ID=2362 for more information

¹⁹⁸ American Petroleum Institute, *Windfall Profit Tax*, (2006) www.api.org/policy/tax/upload/WhitePaper2004_060CRSupdated.pdf

are pouring into oil markets.”¹⁹⁹

In addition to a Windfall Profits Tax, Congress needs to reform the royalty system imposed on companies drilling for oil and natural gas on public land. One-third of the oil and natural gas produced in the United States comes from land owned by the taxpayers, but royalty payments by oil companies have not kept up with the explosion in energy prices and profits enjoyed by the industry.²⁰⁰ A recent Inspector General audit of the U.S. Department of the Interior’s Minerals Management Service concludes that oil companies are pumping oil from federal land without paying adequate royalties to taxpayers for the privilege.²⁰¹ The report cites widespread cronyism, ethical breaches, decimated auditing staff and overreliance on information provided by Big Oil as culprits in the oil industry giveaway.²⁰² Meanwhile the Justice Department unexpectedly announced the welcome news that it has initiated criminal investigations into the Interior Department’s oversight of oil companies.²⁰³ Taxpayers must be fairly compensated for allowing oil companies the privilege of extracting resources from federally-owned land.

Conclusion

This era of high energy prices and record oil company profits is not a simple case of supply and demand. As the evidence indicates, consolidation of energy infrastructure assets, combined with weak or non-existent regulatory oversight of energy trading markets, provides opportunity for energy companies and financial institutions to price-gouge Americans. Forcing consumers to suffer from an inelastic demand to continue to pay high prices—in part fueled by uncompetitive actions—not only hurts consumers economically, but environmentally as well, as the oil companies and energy traders enjoying record profits are not investing those earnings into sustainable energy or alternatives to our addiction to oil. As a result, Amer-

¹⁹⁹ Bhushan Bahree & Ann Davis, *Oil Settles Above \$70 a Barrel, Despite Inventories at 8-year High*, WALL STREET J., April 18, 2006.

²⁰⁰ See DEPT OF THE INTERIOR, OFFICE OF THE INSPECTOR GENERAL, AUDIT REPORT: MINERALS MANAGEMENT SERVICE’S COMPLIANCE REVIEW PROCESS ii, 2, 3 (Dec. 2006), available at www.doioig.gov/upload/2007-G-00011.pdf; Edmund Andres, *Report Says Oil Royalties Go Unpaid*, N.Y. TIMES, Dec. 7, 2006.

²⁰¹ *Id.*

²⁰² *Id.*

²⁰³ Edmund L. Andrews, *Criminal Inquiries Look at U.S. Oil-Gas Unit*, *The New York Times*, Dec. 15, 2006.

ica's consumption of fossil fuels continues to grow, and the impacts of global warming take their toll on our environment. America's addiction to oil is a major source of greenhouse gas emissions that cause global warming. Forty-four percent of America's world-leading carbon dioxide emissions are from the burning of petroleum products.²⁰⁴

Reforms to strengthen regulatory oversight over America's energy trading markets and bolster anti-trust enforcement are needed to restore true competition to America's oil and gas markets.

²⁰⁴ See generally, Energy Information Association, U.S. Emissions Data, www.eia.doe.gov/environment.html (last visited May 21, 2007).