United States of America

Congressional Record

PROCEEDINGS AND DEBATES OF THE 108th CONGRESS, FIRST SESSION

Vol. 149 WASHINGTON, WEDNESDAY, November 5, 2003 No. 159

Senate

Statement of Senator Dianne Feinstein

"On the Feinstein Amendment to H.R. 2673, the FY04 Agriculture Appropriations"

Mrs. FEINSTEIN. Mr. President, this amendment has to do with providing some regulatory oversight over energy trading. It has to do with closing the Enron loophole. It has to do with providing transparency. Energy trades today are not subject to the 2000-passed Commodity Modernization Act. Rather, these energy trades take place electronically, take place in secret, without transparency, with no records kept, with no audit trail available, and with no regulatory oversight to prevent fraud and manipulation in energy trading.

I would like, first of all, from the Derivatives Study Center, to indicate and read a couple of paragraphs from the letter they have sent, which I think defines the issue very well. I quote:

"This regulatory assistance comes at a critical time. According to the Federal Energy Regulatory Commission's Director of the Office of Market Oversight, 'energy markets are in severe financial distress.' Along with the decline in credit quality in these markets, the loss of confidence and trust has led to a ruin in the liquidity and depth of these markets. This legislation will go a long way to address this problem."

Then he defines what derivatives are. This is important for Members to know. It is complicated. We went through this once before. I would like to give you this definition because it is a good one:

"Derivatives are highly leveraged financial transactions, allowing investors to potentially take a large position in the market without committing an equivalent amount of capital. Moreover, derivatives traded in over-the-counter markets are devoid of the transparency that characterizes exchange-traded derivatives, such as futures, and this lack of transparency introduces a greater potential for abuse through fraud and manipulation."

That is exactly what happened. He goes on to say:

"Derivatives are often combined into highly complex, structured transactions that are difficult, even for the seasoned securities trader and finance professionals, to understand and price in the market. Enron used such over-the-counter derivatives extensively in order to hide the nature of their activities from investors. The failure of Enron and the demise of other energy derivatives dealers has had a devastating impact on the level of trust in energy markets."

That is a good definition of what we are trying to do, why we are trying to do it, and what we are trying to involve.

Now I would like to read into the Record a portion of a letter from Eliot Spitzer. Mr. Spitzer is the Attorney General of the State of New York. That is the place where many of these cases are now coming to trial. He says:

"I firmly support your efforts to make energy markets competitive and protect those markets from fraud and manipulation. The bill sponsored by Senators Feinstein, Levin, and Lugar, and under consideration as an amendment to the proposed 2004 agricultural appropriations bill, is a major step toward both goals."

He goes on to say:

"The amendment makes a major contribution to competitive energy markets by initiating an electronic information system to be operated through the Federal Energy Regulatory Commission. This system will provide open access to comprehensive, timely, and reliable wholesale electricity and transmission, price and supply data, greatly expanding the choices of both buyers and sellers. In addition, the reliability of market information would be markedly improved by the amendment's general prohibition on manipulation of the purchase or sale of electricity or the transmission services needed to deliver electricity, and by specific prohibition of the round-trip trading manipulation used so effectively to inflate electricity prices to the public's injury."

This is a letter from the Attorney General of the State of New York. As such, it places an imprimatur of correctness, of need, and of value on the amendment that we introduce today.

Now, what is in that amendment? Specifically, the amendment would improve price transparency in wholesale electricity markets. The amendment directs the Federal Energy Regulatory Commission to do just what Mr. Spitzer said it would do: to establish an electronic system to provide information about the price and availability of wholesale electricity to buyers, to sellers, and to the public. This provision is actually similar to the transparency provision offered by my colleague from New Mexico, Senator Domenici, in the Energy bill.

Secondly, this legislation would prohibit round-trip electricity trades. What is a round-trip trade? It is the simultaneous buying and selling of the same quantity of electricity at the same price, in the same location, with no financial gain or loss. In other words, no commodity ever changes hands. Again, this is similar to a provision that Senator Domenici offered during consideration of the Energy bill. Round-trip or wash trades are bogus trades. No electricity changes hands but the profits from the trades enrich the bottom line of a company's financial report.

In fact, I think we had one company--I believe it was CMS--say that 80 percent of their balance sheet in a given year was from bogus trades. And there is nothing we can do about it? Does anyone believe that is right? I think not. I don't think the American people do, and that is one of the reasons these markets are so decimated.

Next we would increase penalties for violations of the Federal Power Act and the Natural Gas Act. Maximum fines for violations of the Federal Power Act would be increased from $5,000--that is nothing to a big company--to $1 million. And maximum sentences are increased from 2 to 5 years. Remember, these rip-offs were tremendous. Just look at the people plea-bargaining from Enron, look at what they did, look at the amounts of money they fraudulently compromised.

This language is identical to section 209 of the Senate-passed Energy bill. Current fines are extraordinarily low and, therefore, provide no deterrence to illegal activity.

We also amend the Natural Gas Act to do essentially the same thing. Senator Domenici, in his substitute electricity title to the Energy bill, increased the fines in the Gas Act but he did not do so in the Federal Power Act. We would do both in this amendment.

Next the amendment would prohibit manipulation in electricity markets. Manipulation is prohibited in the wholesale electricity markets, and FERC is given discretionary authority to revoke market-based rates for violators.

Strangely enough, manipulation of energy markets is not prohibited in current law. Can you believe that? Manipulation of energy markets is not prohibited in current law. This would add language to Part 2 of the Federal Power Act to do just that.

Most importantly, this bill would repeal the Enron exemption and allow the Commodities Futures Trading Commission, which has oversight over virtually all other trading, to monitor the over-the-counter energy market.

This would repeal what happened in 2000 when Enron pushed the Commodities Futures Modernization Act exemption for large traders in energy commodities. And it would apply antimanipulation and antifraud provisions of the Commodities Exchange Act to all over-the-counter trades in energy commodities and derivatives.

In my view, when Congress exempted energy from the Commodities Futures Modernization Act of 2000, it created the playing field for the western energy crisis of 2000 and 2001.

The western energy crisis cost millions of people millions of dollars in my home State of California. So this is a charge I am making. When this Congress permitted the Enron loophole to exist in the Commodities Modernization Act, they created the loophole for the playing field that Enron and others used to manipulate the western energy markets.

Next, our bill would provide the Commodity Futures Trading Commission the tools to monitor over-the-counter energy markets. Over-the-counter energy trade in energy commodities and derivatives performs a significant price discovery function, including trade on electronic trading facilities. Our amendment requires large, sophisticated traders to keep records and report large trades to the Commodity Futures Trading Commission. This doesn't change the law. It only applies the law that exists for futures contracts to over-the-counter trades in energy markets.

We would limit the use of data. This requires the CFTC to seek the information that is necessary for the limited purpose of detecting and preventing manipulations in the futures and over-the-counter markets for energy, to keep proprietary business data confidential, except when used for

law enforcement purposes. This does not require the real-time publication of proprietary data. It does not.

This would have no effect on nonenergy commodities or derivatives. The amendment would not alter or affect the regulation of futures markets, financial derivatives, or metals. We have specifically stated on page 20 the following:

"The amendments by this title have no effect on the regulation of excluded commodities under the Commodity Exchange Act."

In addition, we state:

"The amendments made by this title have no effect on the regulation of metals under the Commodity Exchange Act."

Mr. President, my colleagues may be asking themselves why I continue to press this cause. Here I note that Senator Levin has come to the floor. I want the Senate to know how helpful the Senator from Michigan has been in working on this complicated issue. He has spent hours and hours of his time. His staff has worked with my staff in evolving this measure. We have carefully vetted it. I believe we really know what we are doing here.

The energy crisis in the West demonstrated that, without Federal oversight, a business becomes solely concerned with its bottom line and not with any sense of ethical behavior; and arrests and convictions to date have clearly documented this to be the case.

Californians are still paying the price of this unethical behavior. I make the point that we are not talking about one bad player in the California market. This goes way beyond Enron. It extends to others as well--to Reliant, Dynegy, Williams, AEP, CMS, El Paso Merchant Energy, Duke, Mirant, Coral, Sempra Energy Trading--unfortunately, in my own State--Aquila, the City of Redding, Morgan Stanley Capital Group, Pacificorps, and to the Puget Sound Energy.

We believe California was duped out of $9 billion. The Federal Energy Regulatory Commission has illustrated its inability to refund California the money it is owed by recently recommending settlements that in no way, shape, or form reflect the damage that was caused to both consumers and the economy of the largest State in the Union. In fact, FERC settled with Reliant on August 29, allowed them not to admit wrongdoing, and fined them $836,000. That was $836,000 for rules of conduct that cost the State $13 million--hardly fair.

This disproportionately low fine gives credibility to the fact that the price one would have to pay in penalties, if caught manipulating the market, is worth the risk since the benefits of not getting caught far outweigh any penalty that may be levied upon a company.

I think it is pretty clear that this disproportionately low fine gives credibility to the fact that the price one would have to pay in penalties, if caught manipulating in the market today, is worth the risk. There is no deterrence, since the benefits of not getting caught far outweigh any penalties that may be levied on a company. That is what we are trying to change.

If I left any doubt in my colleagues' minds about the widespread manipulation that took place during the western energy crisis, let me point out some recent examples of a case that was brought by the Securities and Exchange Commission against David Delaney, a former chief executive with two of the most prominent divisions of Enron.

On October 30, 2002, Delaney pled guilty to insider trading. The SEC brought charges against him for selling millions of dollars in Enron stock at a time he knew it was being manipulated. While these charges appear to be financial in nature, the underlying facts of the case were that Enron was engaged in manipulative business practices, especially in California.

In March of 2003, the FERC staff report on price manipulation in western markets: Investigators said they suspected Enron was using price information obtained in regulated deals to manipulate trades in unregulated energy derivative markets.

In one instance, Enron manipulated the price of physical gas, upward, then downward. Although the price change in the physical markets was only 10 cents per million Btus, Enron profited due to the effect that this small change in the physical price had on its large financial position. Enron earned more than $3 million in the unregulated over-the-counter markets, while losing only $86,000 on the physical sale of natural gas.

I think it is important to note that the FERC report also states:

"Enron's corporate culture fostered a disregard for the American energy customer. The success of the company's trading strategies, while temporary, demonstrates the need for explicit prohibitions on harmful and fraudulent market behavior and for aggressive market monitoring and enforcement."

That is what we are trying to provide in this amendment. That is what FERC says is missing.

Our amendment would provide greater oversight over these markets so that fraudulent and manipulative behavior could be prevented. It would increase the penalties if, in fact, a company

engaged in fraudulent or manipulative behavior, and it would outlaw all types of manipulation including round-trip trading, wash trades, false reporting, churning, and deliberately withholding generation. All of the Enron trading strategies, such as Ricochet, Death Star, Get Shorty, Fat Boy, Non-Firm Export, Load Shift, Wheel Out, Black Widow, Red Congo, and Cuddly Bear: these are euphemisms for fraud and manipulation and our amendment would cover them all.

It is not clear to me why energy derivatives are not regulated while the Federal Government oversees some physical energy transactions. In other words, if I buy natural gas, and it is delivered to me, then that transaction is overseen by FERC, which has the authority to ensure that this transaction is both transparent and reasonably priced.

But a giant loophole is opened where there is no Government oversight, when transactions are carried out in electronic exchanges. As a result, if I sell natural gas to you, and you sell it to someone else who sells it to another person who then sells it again, none of these transactions are covered by FERC or the CFTC. Because of that, what we saw in the western energy crisis is that this particular loophole allowed energy companies to manipulate prices and to escape any investigation or prosecution by any regulatory agency.

Our amendment will close the loophole, as Senator Levin said, created in 2000 when Congress passed the Commodities Futures Modernization Act.

The loophole exempted energy trading from regulatory oversight, and it excluded it completely if the trade was done electronically. At the time, Enron was the main force behind getting this exemption in this act. By closing this loophole, the amendment will prohibit fraud and price manipulation in all over-the-counter energy commodity transactions and provide the CFTC the authority it needs to investigate and prosecute allegations of fraud and manipulation.

Opponents of this amendment have questioned why we need to explicitly give the CFTC this authority. The answer is we need to give the Commodities Futures Trading Commission this authority because we learned during the western energy crisis that there was, in fact, pervasive manipulation and fraud in energy markets, and that FERC and the CFTC were either unable or unwilling to use the authority they had to intervene. I think Mr. Delaney's plea bargain is eloquent testimony to that.

We need to give the CFTC this authority because we need regulators to protect consumers and make sure they are not taken advantage of. We need to give the CFTC this authority because, when there are inadequate regulations, consumers are ripped off. Let me be clear. Our amendment will provide the same protections to consumers in energy markets as these same consumers have in all other commodity markets such as the New York Merchantile Exchange or the Chicago Merchantile Exchange. Our amendment does not provide more regulation or greater oversight than what currently exists for other commodity markets, merely the same protections: Protections which are currently lacking.

In fact, in an effort to avoid onerous or complicated requirements, Senator Levin, Senator Lugar, and I have worked together to make sure the recordkeeping and reporting requirements are very clear. Our amendment only requires traders to keep records of over-the-counter trades in energy commodities and derivatives that perform a significant price discovery function. In other words, these are the trades that affect the pricing for everyone. These are the big trades, and these are the trades where there needs to be transparency because they affect the market.

If I am a large company and I sell you 1,000 decatherms of natural gas in a typical transaction on the spot market, this is a price discovery transaction because the prices of these transactions are usually covered and reported by the press and will affect prices of subsequent transactions. Trades on electronic markets serve, by their very nature, as price discovery functions. They should be available for everyone to see because they will very likely influence what price the next trader will buy or sell at in an open and transparent fashion.

Our amendment would require traders to keep records of their trades and to maintain an audit trail. This requirement would simply regulate energy trading in the same way other finite commodities are handled. Why should pork bellies or frozen concentrated orange juice have more protection for consumers than electricity?

There is nothing in this amendment that should be burdensome for traders in any way. I would think responsible traders would already be keeping records and maintaining an audit trail for their own protection in this world. In fact, the amendment only allows the CFTC to seek information to investigate allegations of wrongdoing.

We have worked for almost 3 years to craft this provision. It has had hearings in the committee. It has been discussed on the floor. We have met with dozens of people. We understand there are those who do not want to support it. But in not supporting it, what they are doing is condoning a marketplace that has practiced deep fraud and deep manipulation and for the most part

gotten away with it.

I don't think we do our job as Senators if we can't protect an unsuspecting public. As the Derivative Center pointed out, these markets are in disarray now. Why are these markets in disarray? They are in disarray because people do not have confidence in them. They are in disarray because there is no transparency because there are hidden markets, and when they explode, they explode big time.

Why should Mrs. Smith from Texas or Mr. Jones from Pennsylvania or Mr. Cornyn from Texas invest in these markets? Why should he? He wouldn't have confidence in them. He would have no transparency. He would have no ability to know what is going on.

What we are trying to do is put that confidence back in the marketplace by providing some prudent, commonsense, antifraud, antimanipulation oversight by saying: If you trade this way, you must keep a record of the trade. You must keep an audit trail. And these trades must be transparent so that the Smiths, the Jones, and the Cornyns, if they so desire, can find out what in fact is going on.

Let me stress that this does not impact financial derivatives in any way whatsoever. We have clarified that. Our opponents persist in using the argument that financial derivatives are affected. They are not. Look at page 20, lines 17 to 20, if you want to see it in black and white. Nothing in this provision affects the authority of the Federal Energy Regulatory Commission. We don't change it in any way.

To respond to concerns about trading platforms that only match buyers and sellers, there is no capital requirement. Let me repeat that because people are going around saying there is. To respond to concerns about trading platforms that only match buyers and sellers, there is no capital requirement.

Bottom line: Our amendment merely gives back to the CFTC most of the authority it had before Congress passed the Commodity Futures Exchange Act.

Mr. President, at this point I would like to read into the *Record* a colloquy between the two leaders, Senators Frist and Daschle, which makes clear the parameters of this and why we are on the floor on this bill. If I may:

"Senator Daschle: Mr. President, Senator Feinstein has a market manipulation amendment that she was seeking a vote on. It is my understanding that the agricultural appropriations bill would be the appropriate bill for that amendment. I would inquire of the majority leader, should she offer her amendment to that bill, would she be assured of a vote on or in relation to her amendment with no second-degree amendments, prior to such vote?

"The majority leader responds: The Democratic leader is correct. If Senator Feinstein offers her amendment to that bill, she will get a vote on or in relation to it."

I just offer that to clarify the present legal situation.

I have stated in the Senate numerous times it is the duty of this Congress to make sure our regulators have all the authority they need to prevent fraud and manipulation in the energy markets. Simply put, this is what our amendment does.

Enron remains the perfect example of how the systems were so easily gamed. After Enron successfully lobbied for an exemption to the Commodity Futures Modernization Act in 2000, they and others in the energy sector quickly took advantage of this new freedom by trading energy derivatives absent any transparency and regulatory oversight. In other words, in secret. Thus, after the 2000 legislation was enacted, Enron began to trade energy derivatives literally without being subject to proper regulatory oversight. That is how all these schemes came about. Some hot-shot trader, sitting in front of his computer, found a way to evolve a strategy for the fraudulent and manipulative action of the marketplace. They let these various strategies play out.

Unlike the NASDAQ, from which timely electronic trade reports are available to the public, even prior to its transparency-enhanced reforms in 1997--in 1997, the NASDAQ reformed itself to make their traders more transparent--EnronOnline did not offer timely reporting of executions. This means EnronOnline provided no data regarding recently executed transactions. Consequently, even after the trades, basic market information was not provided to market participants.

It should not surprise anyone that without basic transparency, without the ability to see what is happening, prices would soar. What interests me is they did and yet there is still resistance to this legislation.

In 2 years, Enron's derivatives business had been a stand-alone company. It would have been the 256th largest company in America. That year, according to author Robert Bryce, Enron claimed it made more money from its derivatives business, $7.23 billion, than Tyson made from selling chickens. That is huge, if you think about it. Think what that means. This segment of the market in one year made $7 billion and nobody knew how. No one knew what the trades were. They were all in secret. Nothing was registered. There was no audit trail. There was no

antifraud, antimanipulation oversight. Boom. It happened.

EnronOnline rapidly became the biggest platform for electronic energy trading. But unlike the regulated exchanges, such as the New York Mercantile Exchange, the Chicago Mercantile Exchange, and the Chicago Board of Trade, EnronOnline was not registered with the CFTC. So Enron set its own standards. In other words, it had a very secure, quiet, protected niche on the market.

Others have tried to replicate that. The banks, for example, Senator Levin said, devised something called the Intercontinental Exchange so they could do the same thing Enron has done. It is wrong.

Traders and others in the energy sector came to rely on EnronOnline for pricing information. Yet the company's control over this information and its ability to manipulate it was tremendous. As author Robert Bryce went on to describe--and this is very colorful and true--Enron did not just own the casino. On any given deal, Enron could be the house, the dealer, the oddsmaker, and the guy across the table you are trying to beat in diesel fuel futures, gas futures, or the California electricity market. You tell me that is a good situation?

You tell me this Senate and this Congress should let that happen. We should not. That is just plain wrong. Those who want to protect this secret niche are just dead wrong. It is not in the American people's interest to have a secret trading niche that can be an empire for fraud and manipulation. We need to protect consumers from future Enron-like scams because they are going to happen.

Now, was Enron and its energy derivative trading arm, Enron Online, the sole reason California and the West had an energy crisis? Absolutely not. Was it a continuing factor to the crisis? I certainly believe that evidence has shown it was.

Unfortunately, because of the energy exemptions in the 2000 Commodity Futures Modernization Act, which took away the CFTC's authority to investigate, we may never know for sure. In other words, quite purposely, this Congress, in 2000, let this secret world be created and said:

"We are going to take energy and metals out of the entire trading regulatory structure and we are going to let them go on operating on their own, without the proper oversight. That is exactly what happened. It is just plain wrong."

I repeat, once again, the amendment we offer will subject electronic exchanges such as EnronOnline to the same oversight as other commodity exchanges, such as the Chicago Mercantile Exchange, the New York Mercantile Exchange, and the Chicago Board of Trade--no more, no less. Without this type of legislation, there is insufficient authority to investigate and prevent fraud and price manipulations since parties making the trade are not required to keep a record.

This amendment is not going to do anything to change what happened in California and the West. That is done. But it does provide the necessary authority for the CFTC to protect other parts of this country against this kind of thing happening again. And it well could happen.

Nobody thought we would ever see the kind of event that blacked out most of the East Coast and the Midwest, but we did. Nobody thought we would ever see what happened in the West, but we did. Nobody ever thought anybody would come up with schemes like "Ricochet," "Death Star," "Get Shorty," "Fat Boy," but they did. Nobody thought they could use them to commit a manipulation of the market, but they did.

I will leave you with one fact: The total cost of electricity in California in 2000 was $7 billion. The cost the next year was $28 billion. Does anyone believe that market forces--namely, supply and demand--could account for a 400-percent increase in the cost of electricity in a year? The answer has to be no. The answer has to be that bad things were done.

So we have worked on this amendment. I sit on the Energy Committee. I have tried to pay a great deal of attention to these matters, to follow this, and I am absolutely convinced that America and the business climate of America is much better off when things are transparent, when there are records kept, when there is a regulatory authority that can say: Whoa. Something may be going haywire. Let's take a look at it. That is all we do--no more and no less than for any commodity.

I wish to say one other thing. A financial derivative is not like an energy derivative. For people to confuse this and say it affects financial derivatives is not right. Energy is a finite commodity. There is a beginning and there is an end, and it is different from a financial derivative.

I believe the CFTC has antifraud and antimanipulation oversight on futures exchanges but not on over-the-counter energy trades. That is the difference here. We would cover over-the-counter energy trades and particularly those trades that are electronic.

I also want to show where existing law is inadequate. There is a case that has just been brought to my attention which I think shows that the existing law is inadequate, and this is what we are trying to fix.

Two energy traders from the energy firms Dynegy and El Paso were charged by the U.S. Government with reporting false information on a number of trades--at least 48 trades. They falsely reported the number and the prices used in trades they conducted involving natural gas in an attempt to influence the natural gas spot price indices.

The Federal indictment charged them, among other matters, with wire fraud and violation of the Commodity Exchange Act, which is what we are talking about, provisions prohibiting price manipulation and dissemination of false information about energy commodity rates.

The Federal court allowed the wire fraud charges, but it dismissed the Commodity Exchange Act charges on the ground that the wording of the act failed to prohibit persons from knowingly providing false information. While the CEA used the word ``knowingly'' in an earlier part of the provision, the court ruled that the word had to be repeated in the section prohibiting false information.

The Feinstein-Lugar-Levin amendment would clarify the wording of the CEA provision to resolve the problem identified by this Federal district court in the case of the *United States of America v. Michelle Valencia, Criminal Action No. 8-03-024.*

That is a pretty clear indication of where present law is not adequate. These were bogus trades. These trades never took place. There were totally bogus, and yet the wording in the Commodity Exchange Act, which we are trying to fix, was judged by the court as too vague to take any action.

Second, I want to make this point: What we are trying to do is prevent fraud and manipulation. We are trying to prevent it and deter it from happening. The soft penalties we have now don't prevent it. That should be very clear. We toughen the penalties in the Electricity Act and in the National Gas Act. Clearly, a number of these schemes that Enron practiced, whether it was "Death Star," "Ricochet," or "Black Widow," or any of these other terrible schemes, took place. Our bill would specifically prevent them.

We are trying to prevent and deter, and the way we do that is by strengthening the law.

I am really puzzled by the administration's position. I am really puzzled because it seems to me they should be on the side of the American people, not on the side of the traders and those who want to get rich quick from this open marketplace.

Additionally, it is interesting to me that the President's working group, when it came out in 1999, specifically said:

"Due to the characteristics of markets for nonfinancial commodities with finite supplies"--that is energy–"however, the working group is unanimously recommending that the exclusion"--the exclusion from the bill–"not be extended to agreements involving such commodities."

So beginning in the year 2000, they have done a total switch and I do not understand why, particularly after the events of 2000 and 2001, where we know fraud and manipulation was explicit. Now when the Government tries to go after two companies for bogus trades, a court finds the Commodities Exchange Act is inadequate; it is vague.

Why would people oppose what we are trying to do? I think we are on the side of the angels.

Let me quickly go over some points. Why do we need this legislation? We need it because companies are now permitted to trade large amounts of energy in virtually unregulated markets, which makes it easier for unscrupulous companies such as Enron to manipulate the price of energy. The bill would close the Enron loophole that allows this unregulated trading.

Secondly, do we have any examples of how these markets have been manipulated? FERC recently released a 1-inch thick report on how the markets for electricity and natural gas in the western United States were manipulated in 2000 and 2001. So we know it happened. The FERC found Enron and other companies lied about the prices of their trades, reported fictitious trades to drive up prices, did wash trades with each other, and engaged in rapid trading to drive prices up and then back down, reaping millions of dollars of profits in the process and costing customers billions of dollars in unjustified energy costs. That is according to FERC. That is a finding in their study. Yet people still oppose this legislation. Unbelievable.

Would this legislation have prevented these manipulations? Under current law, the CFTC is totally in the dark about what goes on in the over-the-counter markets. Under this legislation, manipulation in these markets would be a felony and the CFTC would get reports about large trades in the over-the-counter markets, so it would be able to monitor these markets, something it cannot do now. Should anybody be able to escape from ongoing monitoring of what they do in these markets, big traders? I do not think so. Yet they are in this little loophole that was created. That was the purpose of the loophole, to prevent anybody from looking; keep no records.

Therefore, they are not going to be able to catch us, and there will be a weak law so it will not be sustained in court when they try to bring a case.

Another question: Enron is bankrupt. A number of traders have been fined and energy trading is back on the rise. The marketplace seems to be correcting itself. Why is this legislation needed?

It is needed to avoid more problems like we have just had. Although everything mentioned in the question I just asked may be true, there is one other significant fact. The consumers and businesses that paid higher prices have only recovered a small fraction of their losses. It is better to prevent the manipulation and the losses from happening than try to make up for them after they take place. That is the point. What our agencies have shown is there is, up to this point at least, no way for an aggrieved marketplace to recover its losses from fraud and any manipulation. Therefore, it should be our job to see the laws are accurate and in place to prevent this kind of activity from taking place in the beginning. That is where increasing the penalties comes in.

Imagine, a $2,000 penalty for doing this. That is nothing. That is not even a slap on the wrist for multibillion-dollar companies.

How does one respond to the concerns that this legislation will increase costs and uncertainty and scare off investment in the energy markets? It will not. The regulated U.S. commodities markets are the most successful and reliable in the world. Ever since the agricultural exchanges were first regulated, we have heard dire predictions from commodities traders that regulation will drive business overseas. In fact, the opposite has happened. We have seen a flight to quality as investors seek safe and reliable markets. That is a fact. This helps the market.

Many traders and energy companies have said the actual cost of compliance with this legislation will be minimal.

The final question: Why should energy derivatives be regulated differently or more stringently than financial derivatives? Because we do not touch financial derivatives. Mr. Greenspan, please know that.

The price of energy derivatives can be manipulated by manipulating the supply of the underlying energy commodity. The price of financial derivatives is very difficult to manipulate because it is difficult to manipulate the price of financial measures underlying the instruments, which generally are not commodities but abstract financial measures such as interest rates and currency exchange rates.

Then again, in 1999, the President's working group saw this. They recommended they not put energy into the loophole. The Congress saw differently and put energy into this loophole, and the never-never land of secrecy went on. These bogus trades were enabled. These bogus trades took place.

There are cases being brought, and we are even finding that the law is inadequate because a court has said it is too vague. We correct that.

I think this is really an important amendment. I do not think I could live with myself if I did not try to do it. If we lose today, believe me, I will come back again and again, because we saw what happened. We know there was massive fraud and manipulation. We know the loophole was there. We know there is no transparency, no record, no audit trail, and no antifraud and antimanipulation oversight for any over-the-counter energy trade. That is what we are trying to do.

My colleagues have referred to futures exchanges rather than over-the-counter energy trades, and that is what we are referring to in this bill. Please, I know back here people look at the West and they say, aha, it is not us, but what I say to them is some day it could be them. Do they not want the law right? Do they not want to be protected? Do they not want a record kept so the regulatory agency can look at it? I really hope the answer is yes, and I hope this Senate will vote for this amendment.

This is a report entitled ``The Over-the-Counter Derivatives Market in the Commodity Exchange Act" which was written by the President's working group on financial markets in 1999.

On page 16 of that report, it goes on to say--and I want to read it in its context:

“Due to the characteristics of markets for nonfinancial commodities with finite supplies” – which energy would be one – “the working group is unanimously recommending that the exclusion”-- In other words, the loophole-- “not be extended to agreements involving such commodities. For example, in the case of agricultural commodities, production is seasonal and volatile and the underlying commodity is perishable, factors that make the markets for these products susceptible to supply and pricing distortions and to manipulation. There have also been several well known efforts to manipulate the prices of certain metals by attempting to corner the cash or futures markets. Moreover, the cash market for many nonfinancial commodities is dependent on the futures market for price discovery. The CFTC, however, should retain its authority to grant exemptions for derivatives involving nonfinancial commodities as it did in 1993 for energy products, where exemptions are in the public interest and

otherwise consistent with the Commodities Exchange Act."

Then the loophole was promulgated. The section of the Commodities Exchange Act which contains that loophole is section 2(g) and is titled, "Excluded Swap Transactions." The section reads:

"No provision of this Act (other than section 5a (to the extent provided in sections 5a(g)), 5b, 5d, or 12(e)(2) shall apply to or govern any agreement, contract or transaction in a commodity other than an agricultural commodity if agreement, contract or transaction is.....".And then it goes on.

This section in the Commodities Exchange Act is what creates the loophole, and that is the problem that we are trying to correct in this legislation. I believe we do correct it.

Again, it is very hard for me--and this might have something to do with the fact we went thorough it in the West--to understand why we would not want to deter this activity and strengthen the rules to prohibit such manipulation from happening in the future.

We want to be very certain that with all of this kind of trading, including over the counter trades and electronic trades, that the records are kept and there is an audit trail clearly exists and there is an opportunity for the Commodity Futures Trading Commission to note something may be wrong and hold the proper investigation. This is no more and no less than what exists on the exchange today.

Why should this secret world of trading be allowed to exist? I know people get rich through it. This secret trading world allows people to get rich by engaging in fraudulent trades, as was seen during the Western energy crisis. It is this type of manipulative behavior that we are trying to stop.

I can't understand why the administration would not want to support this. When Mr. Greenspan came in and talked to me a few years ago when we first proposed this legislation, his main concern was financial derivatives. This is why we made certain, as I have said in my comments, that this legislation does not concern financial derivatives. He may well have expanded his view to all kinds of over-the-counter trades since then, but at the time I sat down and met with him, that was not his position.

Regardless, we are talking about public policy. We are talking about protecting the people of America. We are talking about strengthening the law so that what happened on the west coast can never happen in the Midwest or on the east coast or any part of the nation.

I mentioned what the Attorney General of the State of New York--the Attorney General, not a deputy--Mr. Spitzer, has written. Once again, let me read what he said. He is the one who prosecutes many of these cases and I really think his views in this area should make a difference. He says:

"I urge your amendment's adoption. In addition to providing wholesale electricity markets, the transparency vital to effective competition, the amendment closes loopholes used to manipulate energy markets. It improves the ability to detect fraud and other manipulation, and it deters manipulation by establishing substantive penalties."

This is the Attorney General of the State of New York who is going to be prosecuting many of these cases. He says it is a wise thing to do, it is a prudent thing to do, and you should do it.

He also says that this amendment makes a major contribution to competitive energy markets by initiating an electronic information system to be operated through the Federal Energy Regulatory Commission. I have already talked about this. Earlier, I said how this legislation will provide open access to comprehensive, timely, and reliable wholesale electricity and transmission prices. The attorney general repeats that. He says:

"The reliability of market information would be markedly improved by the amendment's"--Don't we want that? I think so--"general prohibition on manipulation of the purchase or sale of electricity, or the transmission services needed to deliver electricity and by the specific prohibition of the round trip trading manipulation used so effectively to inflate electricity prices to the public's injury.

This is the prosecutor in one of the main States that would have this kind of litigation. Then he goes on to say:

"Enforcement of the law and regulation safeguarding our energy markets would be greatly aided by other reforms the amendment provides. The amendment would repeal the so-called Enron exemption which shields large energy traders from oversight."

Once again, I want to iterate that this is the Attorney General of New York speaking.

"In addition, the amendment would apply to anti-manipulation and anti-fraud provisions of the Commodity Exchange Act"-- I just read this provision to you – "Clearly this section of the Act is inadequate by anybody's reading to effectively regulate all energy transactions."

Our legislation would improve the Federal Energy Regulatory Commission's ability to address

complaints, and it would lift the restriction on the Federal Energy Regulatory Commission's authority to order refunds. These reforms will make accountable parties, which are currently beyond the law's reach accountable for their actions and will increase recovery of overcharges.

Once again, I ask, don't we want to do this? Do we really want to protect these people who are willing to do such harmful things to the American people?

I am shocked at the administration's letter. I thought they were there to protect the public.

Madam President, there really is a difference of opinion here. I would like to have the time to read part of the transcript in a hearing on the Committee on Agriculture on July 10. A question that Senator Crapo asks to Mr. Newsome of the CFTC.

"Senator Crapo: I know we have been over this before but I want to be sure that I have it right. As I listened to the testimony of both of you it seems to me that there is actually a lot more agreement than disagreement with respect to what we ought to be doing and where we ought to be. The disagreement, as I understand it, is over whether 2G excludes from the fraud and manipulation provision swap transactions.

"Now, swap transactions are the dominant majority of what goes over the over-the-counter market.

"I am correct about that. Would the two of you agree that is the core of the disagreement between your testimony?

"Mr. Newsome: 2G certainly does exclude swap transactions."

That is my point. And he is testifying to it in this committee that this is not covered by the CFTC. It goes on.

"Senator Crapo: It excludes them from fraud and manipulation protections.

"Mr. Newsome: 2G excludes them from jurisdictions of the CFTC."

The PRESIDING OFFICER. The Senator's time has expired.

Mrs. FEINSTEIN. I thank the chair.