Testimony of

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TESTIMONY OF WISCONSIN ATTORNEY GENERAL
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Mr. Chairman and members of the Committee, thank you for this opportunity to speak with you here today.

Late last summer following Hurricanes Katrina and Rita, Americans saw gasoline prices surge to all-time highs, and six months later those prices have still not abated to previous levels. At the same time, consumers began hearing dire predictions of skyrocketing natural gas bills for the winter ahead; predictions that unfortunately proved to come true.

Many states, including Wisconsin, conducted their own individual inquiries into the enormous jump in gasoline prices and the industry's resulting record profits. At the same time, beginning in the fall of 2005, the offices of the Attorneys General of four Midwestern states, Wisconsin, Iowa, Illinois and Missouri, launched a joint investigation for the purpose of examining the reasons for the dramatic rise in natural gas prices. Our staff met with invited representatives of utility companies from each state, as well as with natural gas producers, to gather information and obtain frank perspectives about the causes of the projected dramatic price increases.

What we found surprised us. Our six-month investigation resulted in two primary conclusions: 1) the upward volatility of natural gas prices over the past several years cannot be simply explained by traditional supply and demand factors, contrary to what is commonly reported; and 2) the financial markets for natural gas are enormously complex, and there is an almost complete lack of transparency in the system.

Data collected for our report from both government and industry sources indicate that daily consumption of natural gas today is virtually unchanged from levels of ten years ago, contrary to media reports that routinely refer to "soaring" or "skyrocketing" demand. In addition, on the supply side, the reserve to production ratio has actually gone up the past six years and storage levels this fall and winter were at all-time highs. These facts are best illustrated on the charts attached and identified as Exhibits ES-2 and ES-3, part of a lengthy report detailing the findings of our investigation.

Physical market fundamentals - a tight supply/demand balance - are not adequate to explain either the short-term or long-term behavior of natural gas prices. This does not mean that tight markets do not matter - of course they do - but identifying physical market fundamentals is only the beginning of the story, not the end.

On the financial side, it is clear that financial markets for natural gas are far less regulated than the markets for many other less-essential commodities, there are few regulations for registration or reporting by brokers and, to make matters worse, information regarding who is holding what positions is almost non-existent or unobtainable. Indices in the natural gas market are based largely on self-reported trades. Indeed, from a law-enforcement perspective, it is almost impossible to ascertain whether any antitrust, consumer or securities laws are being broken, in that we don't have access to the information typically used to conduct those sorts of investigations. We can't answer the most basic questions, such as who bought what, and when?

The widespread reliance on natural gas commodity markets to set prices is an extremely recent phenomenon, just over 15 years old. As evidenced by the wild, irrational swings in natural gas prices over the past several years, at a time when supply and demand were relatively stable, these new markets have not worked very well. Many of the industry representatives we spoke with believe these markets lack transparency and are vulnerable to abuse and manipulation.

The upward spiral of gas prices has an enormous impact on our economy and on consumers' checkbooks. Consider the following:

? The wellhead price of natural gas in the six-year period of 2000-2005 increased by over $400 billion dollars compared to the previous six years

? Winter heating bills in the Midwest this winter are projected to be up by $250 per household, or 28 percent, compared to last winter, despite a 5 percent decline in consumption and record levels of gas in storage. They are up by over $600 compared to five years ago.

? A $3 per million Btu rise in natural gas prices costs consumers an additional $5 billion per month.

? Natural gas prices climbed to all-time highs last fall and early winter, with spot prices exceeding $15 and wellhead prices exceeding $10 per million Btu for the first time ever. By contrast, gas prices had hovered around $2 to $4 per million Btu for much of the last two decades.

This story has a very human side to it as well, as evidenced by stories told to members of our investigatory committee. For example, one Illinois school district spent about $300,000 for heating in 2002. By 2005, it had jumped to $400,000. In fiscal 2006, it's approaching $700,000. That's more than double in four years. A retired factory worker in Chicago barely makes ends meet on $1,100 per month. Last December his gas bill balance was $430--double what it was at the same time last year. In Wisconsin it is estimated that 20,000 more families will be delinquent in their utility payments this winter compared to a year ago, despite extraordinarily mild temperatures during January. Without the assistance of public funds, those families will face service disconnections in the coming months.

This committee's examination of consolidation in the energy industries is an important issue that ties directly into the concerns raised in our report. For example, consider that BP, the largest marketer of natural gas, has a market share of over 20 percent. The next three firms have market shares of about ten percent. In other words, four companies (three of which are major oil companies) control about fifty percent of the U.S. natural gas market, and the concentration of ownership continues to increase.

Given the low elasticities of supply and demand and the reactions of the market to relatively small changes in the supply/demand balance, the growing consolidation of ownership in the natural gas market by companies that often have arms that engage in extensive trading presents the potential for market manipulation and other abuses. Putting all our eggs in the baskets of a few energy companies does not bode well for American consumers.

These price increases are a problem that is both regional and national, but which is not beyond our reach. A cooperative approach to this common problem is the most effective and efficient means to determine what legal strategies to employ or public policy changes to advocate to best address any avoidable financial harm to the citizens of our states. A comprehensive approach must be taken, with the states working with the federal government, including Congress, FERC and the CFTC, to arrive at a global solution that creates a more rational, transparent system of markets for energy commodities.

What is clear as we examine this issue, however, is that we must not be satisfied with an explanation that rests solely on traditional notions of supply and demand. Our investigation does not support the commonly repeated mantra that "soaring" demand is driving natural gas prices. Both demand and supply have been relatively flat and steady over the past decade. The price of natural gas, meanwhile, has been all over the place, with peaks and valleys that constantly ratchet upwards. (See Exhibit ES-7, attached.) This pattern does not square with traditional economic analysis of supply and demand. In addition, it appears that a significant contributing factor has been a huge influx of money into largely unregulated financial markets, reinforcing the upward spiral of prices by increasing volatility and risk, and creating uncertainty. A lack of transparency in those speculative markets only makes matters worse.

To address this we submit the following initial list of recommendations:

? Increased oversight of the over-the-counter markets is needed, including requirements for registration of traders and reporting of trades;

? Stricter limits on positions held by any one entity and expanded settlement periods for short- and long-term contracts, and restrictions on how much the price of natural gas can move on the markets before trading is temporarily halted for a "cooling off" period; and,

? Formation of a joint federal-state task force to examine critical questions about the supply-side of the physical market and the role of major oil companies, which straddle the physical and financial markets.

Thank you for your attention to this issue of critical importance to so many Americans, and thank you for allowing us to share our perspectives with you hear today. We would be happy to answer any questions.

EXHIBIT ES-2: NATURAL GAS DEMAND: 1995-2005

Source: Energy Information Administration, database.

EXHIBIT ES-3: NATURAL GAS RESERVE TO PRODUCTION RATIO

Source: Energy Information Administration, database.

EXHIBIT ES-7: WELLHEAD PRICES AND CHANGES IN
TRADING ACTIVITY

Source: Energy Information Administration, Natural Gas Database.