

Midwest Attorneys General Natural Gas Working Group

March 7, 2006

Report from Working Group of State Attorneys General Finds Market Fundamentals Can't Account for Huge Increase in Natural Gas Prices Supply and Demand Alone Don't Support \$50 Billion Increase from 2004 to 2005

WASHINGTON, D.C. — A six-month study into skyrocketing natural gas prices and erratic natural gas markets concludes that traditional factors of supply and demand alone cannot account for the surge in prices and that a huge influx of money into speculative financial markets has reinforced the upward spiral of prices.

The report was released today by four Midwestern Attorneys General: Lisa Madigan of Illinois, Tom Miller of Iowa, Jay Nixon of Missouri and Peg Lautenschlager of Wisconsin. Miller, Nixon, Lautenschlager and a representative of Madigan's office discussed the findings of the report at a news conference in Washington. The report examined several causes of the natural gas prices and addressed potential remedies.

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. Future prices today are far above the costs of production and, if realized, could cost consumers hundreds of billions of dollars more, the Attorneys General say. Consumers are already feeling the effects of those increases, with this season's average winter heating bills projected to exceed \$1,000 for the first time in history.

"These price increases are a problem that is both regional and national, but which is often insufficiently explained as a product of growing demand chasing dwindling supplies," said Attorney General Lautenschlager. "As Attorneys General, we are charged with protecting consumers. A cooperative approach to this common problem was 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."

Last fall, the Attorneys General directed their staffs to begin looking into natural gas prices following dire predictions about skyrocketing costs to consumers. 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.

In their discussion of market dynamics, the Attorneys General found greatly divergent opinions and contradictory explanations for the recent roller coaster of prices. But they say a closer look at the physical market for natural gas points to the conclusion that supply and demand fundamentals did not explain the price increases.

"What we found does not support this commonly held notion that a 'soaring' demand is driving natural gas prices," Attorney General Nixon said. "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. This pattern does not square with traditional economic analysis of supply and demand."

The Attorneys General believe 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 hinders effective review as well, they said.

"Under the current system, the Attorneys General have no way of knowing if or when natural gas traders are breaking the law," said Attorney General Miller. "A more transparent system and an end to the completely opaque current system are needed so Attorneys General can make determinations on when and how to enforce the relevant laws."

The four Attorneys General, representing 27 million consumers paying record-high natural gas heating bills this winter, urged the federal government to take action to assert basic jurisdiction over unregulated financial trading that could be contributing to the enormous increases. Common-sense changes in federal oversight policies are needed, they said, to make the markets more transparent and efficient. The policy steps outlined in the report included:

- Oversight of the over-the-counter markets, 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,
- 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.

"Our discussions with industry insiders revealed that the extraordinarily high prices consumers are paying for this essential commodity don't even reflect the actual market for natural gas," said Attorney General Madigan. "Instead of the current method of setting prices based on the actions of just a few traders, we need oversight of all natural gas transactions to make sure that the prices consumers pay accurately reflect the actual supply of and demand for natural gas."

“There is more federal oversight for the trading of commodities like soybeans, pork bellies and orange juice than there is for the trading of natural gas, which is a necessity for many Americans,” Attorney General Nixon said. “Most consumers can live without pork bellies, but they cannot live without natural gas to heat their homes.”

The study for the Attorneys General was prepared by Dr. Mark Cooper, a long-time Washington, D.C. analyst of energy and consumer issues and the author of hundreds of reports over more than 25 years on a wide variety of energy and consumer issues. He also has served as an expert witness for Attorneys General, People’s Counsels and consumer groups in hundreds of state proceedings.

The report is available online on these Web sites: <http://illinoisattorneygeneral.gov>; www.ago.mo.gov; www.IowaAttorneyGeneral.org; and www.doj.state.wi.us/docs/naturalgas.pdf

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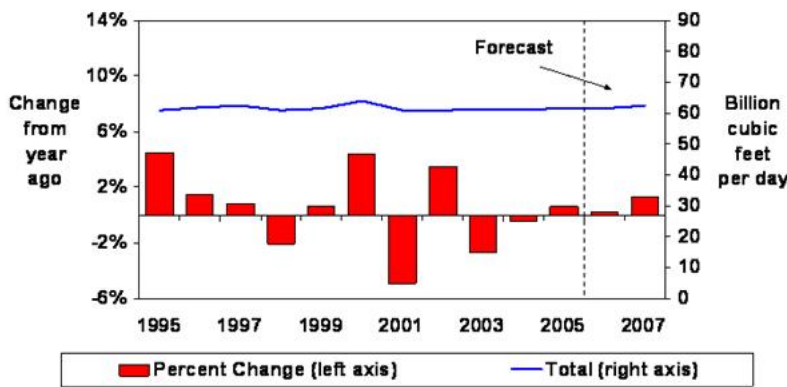
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EXHIBIT ES-2: NATURAL GAS DEMAND: 1995-2005

Figure 12. Total U.S. Natural Gas Demand Growth

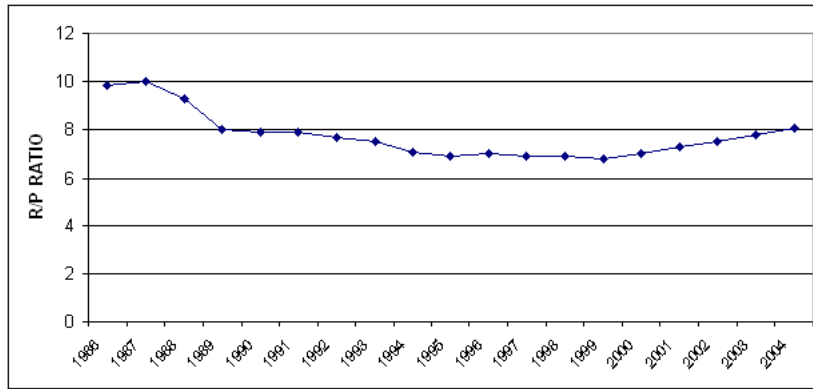


Short-Term Energy Outlook, January 2006



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

HEDGE FUNDS ENTER

OTC-BANKS RAMP UP

ENRON
ENRON EXITS
RAMP
UP

Source: Energy Information Administration, *Natural Gas Database*.

