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Testimony before the
Commodity Futures Trading Commission
Washington, DC

July 28, 2009

Honorable Chairman Gensler and distinguished members of the Commission, thank you for the invitation to testify before you today. I appreciate the opportunity to address the application of position limits and exemptions from position limits in the energy markets.

First, I would like to thank Chairman Gensler as well as Commissioners Dunn, Chilton, and Sommers for holding this hearing; it is a strong sign of your commitment to bring greater transparency, accountability and oversight to commodity markets. Moreover, it is an acknowledgement of an erosion of public confidence in these markets that has resulted from unprecedented volatility, unwarranted price spikes and excessive speculation.

I serve as Treasurer on the Petroleum Marketers Association of America's (PMAA) Executive Committee. PMAA is a national federation of 47 state and several regional trade associations representing over 8,000 independent fuel marketers. These marketers account for approximately half of the gasoline and nearly all of the distillate fuel consumed by motor vehicles and home heating equipment in the United States.

I am also here representing the New England Fuel Institute (NEFI), a 60-year-old trade association representing approximately 1,200 residential heating fuel dealers and related service companies throughout the Northeastern United States. The ability of these dealers to hedge heating fuel costs for products such as heating oil, propane and kerosene is essential to shielding consumers from risk and providing them with a fair market price based on fundamentals. That ability, however, is now being undermined by an erratic market, questionable investment tactics and purely speculative market forces.

Mr. Chairman, I am one of these dealers. I am co-owner and President of Cota & Cota, Inc. of Bellows Falls, Vermont, a third generation family-owned and operated home heating fuel provider in southeastern Vermont and western New Hampshire. My business provides quality home heating fuel, including propane, heating oil and kerosene, to 9,000 homes and businesses. I also market motor fuel, off-road diesel fuel, jet fuel and biofuels. Unlike larger energy companies, most retail fuel dealers are small, family-run businesses. Also unlike larger energy companies, we personally deliver product directly to the doorstep of American homes and businesses. And I bring with me a message from those home owners and businesses – please do everything in your power to fix these broken markets.

The 2008 and 2009 Energy Commodity Bubbles

Our industry has been voicing concern to the Commission and Congress regarding activities in "dark" commodity markets for four years now. It is abundantly clear that large-scale, institutional investors speculating in the energy markets continue to act as the driving force behind energy prices. The rise in crude oil prices, which reached $147 in July of last year only to fall dramatically to $33 in December, was not a result of supply and demand fundamentals – it was the direct result of excessively-leveraged speculators, index investors and hedge funds.

As the price of a barrel of crude oil reached $72 in mid-June 2009, economists, oil company executives, Wall Street insiders, journalists, public officials, and even OPEC were scratching their heads. This summer's run in oil prices was occurring despite a sluggish world economy, increasingly high unemployment, dismal consumer confidence levels, demand for oil at a ten year low, U.S. oil inventories at a 19-year high, and the value of the dollar having been essentially flat over the prior three months. Prices did not reflect the supply and demand outlook for a world in severe recession, and with no reliable predictions of recovery in the foreseeable future.

Gasoline Station Owners and Heating Fuel Dealers Are Struggling Due to Commodity Market Volatility

In 2007 and most of 2008, motor and heating fuel retailers saw profit margins from fuel sales fall to their lowest point in decades as oil prices surged. The gasoline and home heating industries are among the most competitive in the marketplace, which is dominated by small, independent businesses. Retail gasoline station owners, for example, offer the lowest price for motor fuels to remain competitive, so that they generate enough customer traffic inside the store where station owners can make a modest profit by offering drink and snack items. In addition, because petroleum marketers and station owners must pay for the inventory they sell, their lines of credit were approaching their limit due to the high costs of gasoline, diesel and heating fuel. This created a credit crisis with marketers' banks, creating liquidity problems and additional financial hardship for many home heating fuel dealers and by-the-road station owners – and as mentioned, some even were forced to "close up shop."

In the summer of 2008, Goldman Sachs predicted that crude oil would hit $200 per barrel (translating to $6 per gallon heating oil) by winter. Heating oil dealers, who typically purchase fuel in the summer months when seasonal product costs are typically at their lowest, were experiencing higher prices than ever before. Some customers, scared by statements made by Goldman Sachs and others, began demanding a fixed-price agreement with their dealer in an attempt to shelter their family budgets from higher prices. Many dealers offered such contracts to meet this demand, driving many of them to purchase the fuel needed to supply these contracts up front during the summer months; for fear that prices would only head higher. When institutional investors exited the market in the fall, heating fuel dealers and their customers who had “locked in” to a price contract were put in a very bad spot, committed to fuel at a much higher cost than its current worth. Many of these consumers are elderly Americans and struggling families trying to make ends meet in a slumping economy riddled with high unemployment rates, evaporating savings and retirement accounts.

The Commodity Markets Are Broken and Meaningful Reform is Needed

Mr. Chairman and honorable Commissioners, we and our consumers cannot continue down the same path. It is time for a concerted effort toward meaningful reform to restore stability and confidence in these markets. We are aware that the Commission cannot implement all the needed reforms without new statute, and therefore we urge the U.S. Congress to act – and to act swiftly – to give you the additional authorities and resources you need in order to complete your mission of protecting the American public against fraud, manipulation, excessive speculation and abusive and unethical trading activities in the commodity markets.

Wall Street swap traders, exchange traded funds, and speculators do not store, produce, process, transport, market or deliver physical commodities, and therefore, unlike a company like mine, do not fully appreciate the impact on vulnerable Americans. They need to realize that, when investing in finite, consumable commodities, they are investing in products Americans need to go to work, to visit a sick parent hundreds of miles away, to feed their families or to heat their homes. There is a saying that the consumer is always right. How can you possibly be aware of the needs of the consumer when you are pushing paper around an office on the 24th floor of a New York City high-rise?

Energy commodity futures markets were not designed as an investment class – they were set up for physical hedgers to manage price risk by entering into a futures contract in order to lock in a price for future delivery. They were designed as a tool for producers and purchasers of physical commodities to provide a fair price for commodities based on market fundamentals. Speculators were welcome and are necessary in order to provide necessary liquidity and facilitate this risk management, but were never intended to dominate the market and the markets were never intended to exist at their behest. Most of all, financial investors, speculators and swap dealers should have never been classified as physical players in order to receive exemptions from federal oversight and speculative position limits for the non-physical portion of the market

And of significant concern are those speculators who don't know that they are speculators – which some have called "Investulators." These unwitting speculators are so large and lacking in fundamental knowledge of commodities trading that they have dramatically distorted these markets. You will most certainly hear more about this from other witnesses today and in the other planned hearings. But know that this is a problem that is worsening, not subsiding. According to a July 1, 2009 article by *MarketWatch* (which analyzed CFTC data), "passive investors increased their crude oil holdings to the equivalent of more than 600 million barrels in June, up more than 30 percent from the end of last year. Over the same period, crude futures have jumped 60 percent, topping $70 a barrel in early June on the NYMEX."[1] Thus, it is time to return these futures markets to *bona-fide* physical players and to the risk management tool it was intended to be. The abuse of this original intent must end now!

In order to restore integrity and confidence in energy futures markets, PMAA and NEFI urge the Commission to:

- Impose strict position limits on all non-commercial market participants, and across all months and all markets;
- Restrict index funds to much smaller position limits per individual investor in the fund or the same limits applied to speculators for the entire fund;
- Create a new classification – "*Bona-Fide Speculator*" – anyone who has not actively traded commodities futures or has not taken equivalent short positions in addition to long positions cannot be a real speculator; and

[1] Moming Zhou, "As Oil Rallies, Passive Investors Increase Their Holdings," in *MarketWatch*, http://www.marketwatch.com(accessed July 1, 2009).

- Limit passive investors' positions to prohibit them from banding together, and as a consequence, driving up prices. PMAA and NEFI favor strict position limits on all funds and investors, and lower limits for those who buy only through passive investment vehicles like exchange traded funds (ETFs) or index funds. We also urge investors to buy oil stocks rather than index funds because of index funds' ability to have a negative impact on the price discovery function of commodity futures markets.

Below you will find our response to the Commission's questions regarding position limits and hedge exemptions:

1. **Applying position limits consistently across all markets and participants, including index traders, managers of Exchange Traded Funds, and issues of Exchange Traded Notes;**

We strongly support limits on the size of positions that all market participants can take in the energy futures markets. Failure to include index funds, swaps, and other financial energy products has helped break these commercial markets. In the past, position limits were enforced by an exchange, such as the New York Mercantile Exchange (NYMEX). When there was only one open-outcry exchange, setting position limits worked, but now since there are multiple exchanges, we need a different entity – this Commission – to establish position limits. In a complicated market where off-shore, electronic, bilateral, over-the-counter and unconventional trading opportunities exist, a federal authority must set the standard for limits on players in each market and in the aggregate across all markets. This is vital to bring integrity to energy futures markets and to help prevent purely financial trades from overwhelming a finite energy commodity marketplace.

2. **The effect of position limits on market function, integrity, and efficiency;**

Currently, our federal regulatory bodies, investment banks, physical market players and other entities do not have sufficient information to understand the overall dynamics of the marketplace. PMAA and NEFI propose that the Commission facilitate the risk management of clearinghouses by requiring all OTC derivatives to at least clear through a regulated exchange in order to effectively enforce aggregate position limits. This will expose the person or entity attempting to corner a market and would help to mitigate oil price volatility; therefore, risk management is enhanced because marketers see what is happening in all aspects of the trade.

Until meaningful reform is established, we will continue to have substantial market volatility due to excessive speculation because the same player on multiple exchanges cannot be seen by federal authorities. Centralized clearing will help to solve this problem.

3. Whether the CFTC needs additional authority to implement such limits;

PMAA, NEFI and their allies in the Commodity Markets Oversight Coalition continue to urge Congress to amend the Commodity Exchange Act by reversing exemptions provided for in the the Commodity Futures Modernization Act of 2000 (CFMA) for over-the-counter (OTC) derivatives products and swap traders. By requiring that this activity occur out in the open and be made subject to the same anti-fraud and anti-manipulation rules that exist for regulated exchanges like the NYMEX, this will mitigate oil price volatility, help reign in excessive speculation and restore integrity to and confidence in the futures markets.

PMAA and NEFI recommend that derivatives trading be exchange traded, or at a minimum, exchange cleared in order to mitigate energy price volatility and to better manage credit risk. Clearinghouses are only useful to the extent that they have the same guarantees as a regulated exchange. If Congress requires the clearing of OTC derivatives, CFTC could successfully implement aggregate speculative position limits at the control-entity level without new legislation. Still we believe it is important that Congress specifically direct the CFTC to impose aggregate speculative position limits and also provide additional funding to the Commission to effectively enforce these limits. Exemptions from position limits for anyone other than bona fide hedgers for the conduct and management of a commercial enterprise should not be allowed. Bona fide exemptions need direct proportionality to physical product handled. In other words, speculative amounts in excess of direct proportionality for swaps dealers, etc. would not be bona fide, and therefore, would require additional position limits, disclosure, and reporting requirements.

4. What methodology should the Commission use to determine position limit levels for each market?

First of all, we believe that the CFTC should establish a new classification – a "*Bona-Fide Speculator*." Anyone who has not actively traded commodities futures or has not taken equivalent short positions in addition to long positions would not be classified as either a bona-fide hedger or speculator. Therefore, passive investors need to have much smaller limits to prohibit them from banding together and driving up prices.

PMAA and NEFI favor strict position limits on all funds and investors, and lower limits for those who buy only through passive investment vehicles like exchange traded funds (ETFs) or index funds. We also urge investors to buy oil stocks rather than index funds because of index funds' capacity to negatively affect the price discovery function of commodity futures markets.

Second, PMAA and NEFI recommend the establishment of an Energy Market Advisory Board made up of physical hedgers and other stakeholders to advise the Commission on setting appropriate aggregate position limits across all exchanges.

- **What quantitative measures should be used in setting limits on the size of an individual trader's position?**

Upon establishing an advisory committee for the setting of appropriate position limits, the Commission might consult with these market participants on appropriate quantitative measures or formulae for setting limits on individuals or even aggregate trade positions. The Commission might consider setting limits by percentage, the proportion of the open interest of the market or by fixed number of allowed contracts. The Commission, however, should use an absolute number and this number should be consistent across all markets. Limits should be established by a fixed number of allowed contracts for non-commercial speculators on all exchanges.

- **Should limits apply in all months combined, in individual months, and in the delivery month?**

Yes. Limits should apply to the delivery month, single months and all months combined, similar to agricultural commodities. In August 2008, speculators controlled over 70 percent of the open interest on NYMEX oil futures. PMAA and NEFI urge the Commission to take the necessary steps to limit the amount of speculators in the marketplace – thus, non-commercials should never make up more than 30 to 40 percent of the total open interest in the energy futures market. This will allow sufficient liquidity in the marketplace without overwhelming physical hedgers.

- **How should spread trades be incorporated in this calculation?**

Spread trades should have their own separate limits, but limits should apply across all months and trading terminals. The classification of *bona fide* speculator would apply to traders who have taken an almost equal number of outright short as long positions over a 6-month period.

5. Should the Commission limit the aggregate positions held by one person across different markets?

Yes. Also, every individual non-commercial trader needs to be distinguished within hedge funds. For example, if a sovereign wealth fund utilizes 30 different hedge funds for all its similar positions in crude oil, the Commission must require the hedge fund to indentify the sovereign wealth fund or other large entity and its subsidiaries. The aggregate of these individuals doing similar trades across multiple hedge funds to avoid visibility in position limits needs to be stopped.

PMAA, NEFI and our customers need our public officials to take a stand against abusive trading practices that artificially inflate energy prices and severely damage our economy. We strongly support the free exchange of commodity futures on open, well-regulated and transparent exchanges that are subject to the rule of law, oversight and accountability. Reliable futures markets are crucial to the entire petroleum industry and the American economy. Let's make sure that these markets are competitively driven by supply and demand and not purely the speculative whims of an investment community that solely views vital, finite commodities as a place to make a profit.

Thank you again for allowing me the opportunity to testify before you today.