TESTIMONY OF PAUL CICIO
INDUSTRIAL ENERGY CONSUMERS OF AMERICA
BEFORE THE
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

"THE EFFECT OF EXCESSIVE SPECULATION"

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Chairman Levin and Ranking Member Coleman, thank you for the opportunity to testify before this subcommittee on the important issue of excessive speculation in the natural gas market.

The Industrial Energy Consumers of America (IECA) is a non-profit trade association whose membership are significant consumers of natural gas and from every major energy intensive manufacturing sector. Corporate board members are top energy procurement managers who are leaders in their industry, technical experts, strongly committed to energy efficiency and environmental progress. IECA membership represents a diverse set of industries including: plastics, cement, paper, food processing, aluminum, chemicals, fertilizer, brick, insulation, steel, glass, industrial gases, pharmaceutical, construction products, automotive products, and brewing.

At the heart of the matter is that every consumer in the country assumes that the government is protecting their interests and that markets are working and operating with a level playing field. Neither is true. The Commodities Futures Trading Commission (CFTC) knows there are significant market oversight gaps and have failed to act in the public interest. There is excessive speculation but we can deal with it 'if' we have transparency for the regulators to monitor the size of the natural gas volumes that any one player is controlling.

We believe that markets work better when market participants know there is strong government oversight that has the ability to catch and severely penalize market manipulation. Unfortunately there is neither sufficient government oversight nor sufficient penalties to deter manipulation.

All market inefficiencies are paid for by us, the consumer. And, even a relatively small increase in the price of natural gas such as $0.25 cents, amount to significant cost impact of $5.5 billion over the course of a year. And, unlike, many other commodities such as currencies or gold, excessive speculation of natural gas has a direct impact on all sectors of the economy including homeowners, farmers and the manufacturing sector.

The subject of excessive speculation, market power and market manipulation first came to our attention in 2001 and has continued to grow in concern. The signs were obvious but because of the lack of transparency, we could never prove it. This all changed with the implosion of the Amaranth Advisors hedge fund. The fund reportedly lost $6.0 billion on natural gas trades. The Wall Street Journal reported that Amaranth controlled at least 100,000 natural gas contracts which mean they controlled the equivalent of 1 trillion cubic feet of natural gas – the equivalent of 54 percent of our country's monthly demand. Clearly, this looks like market power and market manipulation to a consumer.

IECA member companies are some of the world's largest consumers of natural gas. Natural gas is used as a feedstock and fuel. Member company competitiveness is impacted directly and indirectly from the price of natural gas and the functioning of natural gas markets. Indirectly, the price of natural gas is impacting the price of electricity across the country which further increases the cost impact of higher natural gas prices.

For example, natural gas represents 85% of the cost of making anhydrous which is used to make fertilizer for our farmers. Much of our plastics today are made from either ethylene or propylene and a substantial portion of U.S. capacity is produced using natural gas as the feedstock. In this case 93% of the cost of ethylene and propylene is attributable to the cost of natural gas. Most manufacturers use natural gas as a fuel for their boilers and to co-generate electricity and steam to operate their facilities. There is virtually no substitute.

Member companies historically use hedging practices to protect themselves from volatility and to increase predictability of the purchase price of natural gas. Since 2001, volatility has significantly increased in large part due to excessive speculation which has also increased the cost to hedge. For example, using a ATR (Average True Range 15 week moving average) and comparing May 2000 to June 2007, the volatility is up greater than 100%. If we compare May 2000 to the September 2006 (the time period after the Amaranth implosion) the volatility increased by 475%. Volatility is a manufacturer's nightmare and a trader's dream. Volatility makes it extremely difficult for manufacturers to plan product pricing, capital expenditures and plant operations.

It is now a well known fact that Amaranth continued to increase the volume of natural gas they controlled on the NYMEX and Inter Continental Exchange (ICE) during the spring and summer of 2006. Doing so resulted in higher prices than what would have otherwise been the case. National inventories at the time were above the five year average and domestic production was stable. It is impossible for anyone to accurately determine the premium consumers paid because of Amaranth. However, we can provide perspective.

We can assume that had Amaranth not continued to increase their control of the price by continuing to add to their positions, market conditions would have driven the price lower. In fact, after Amaranth collapsed, so did the price of natural gas. In September 2006, the price was $6.81 per mm Btu and after the Amaranth collapse the price fell in October 2006 to $4.20 per mm Btu, a $2.61 difference. If we assume that only one dollar of the $2.61 price was due to Amaranth, it would have cost consumers an estimated $9 billion over the time period of April thru August of 2006!

The clear responsibility of the CFTC is to ensure that the natural gas market is functioning efficiently, fairly and that the derived market price is trustworthy. That is, without manipulation. They cannot succeed in doing so without greater jurisdiction to provide oversight of both the NYMEX and ICE. It is well known to all market participants that because CFTC has oversight of NYMEX and requires large players to report their positions to the "Commitment of Trader Report", that traders have moved much of their trading volumes to ICE where there is no reporting. Without jurisdiction over ICE, it is impossible for the CFTC to either reduce excessive speculation or make sure that market power and market manipulation does not occur.

The CFTC has known for a long time that a significant oversight gap exists. Because the Chairman of the CFTC has not stepped forward to say there is a problem should raise serious questions by Congress. Why aren't they responsive to the public interest and why haven't they brought these concerns to the Congress? Is a change in their charter necessary?

At least one CFTC commissioner has said there is a problem. Below are the remarks of CFTC Commissioner Michael V. Dunn before the National Grain Trade Council on September 8, 2006.

"However, a large portion of energy trading occurs in the over-the-counter market, mostly beyond the scrutiny of any federal agency. The Commission's enforcement actions continue to uncover repeated examples of people and companies trying to game the energy markets, often in the belief that no one is watching, or that if someone is, there is nothing that can be done to them."

"Because the CFTC is barred from regulating the OTC energy markets, it cannot collect large trader data from unregulated energy markets, or conducting regular surveillance of them. It is virtually impossible to know, therefore, the extent of fraud and manipulation that may be occurring in the over-the-counter markets."

CFTC opines it has subpoena power. It does. But that is not the type of government oversight that is needed. Subpoena power is used after the damage to markets has already been done. We want a preemptive approach that effectively monitors markets and prevents manipulation.

IECA recommends that at minimum, CFTC have oversight of both the NYMEX and ICE and require large traders to report their positions weekly to the Commitment of Traders Report. We also recommend Congress increase the funding to the CFTC for enforcement purposes.

Asking only 'large traders' to report their position to the CFTC, just like the NYMEX does today, is not asking too much of these companies. These same companies do 'mark-to-market' position accounting at the end of each trading day for internal reasons anyway. This is not asking much when the public trust is at stake.   Thank you.