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Testimony before the
Committee on Homeland Security & Governmental Affairs
Permanent Subcommittee on Investigations

United States Senate
Washington, DC
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Honorable Chairman Levin, Ranking Member Coleman and distinguished members of the committee, thank you for the invitation to testify before you today. I appreciate the opportunity to provide some insight on the way that excessive speculation and volatility on the energy commodity markets has impacted small business fuel dealers and the American energy consumer. I trust that my many years of experience in the industry will help shed light on this issue and assist you in your policy-making and oversight endeavors.

I currently serve the Petroleum Marketers Association of America (PMAA) as its Northeast Regional Chair. PMAA is a national federation of 45 states and regional associations representing some 8,000 independent fuel marketers that collectively account for approximately half of the gasoline and 80 percent of the heating oil sold in the United States.

I am also President of the New England Fuel Institute (NEFI), a 60-year-old regional trade association located just outside Boston, and as such, I am here representing well

over 1,000 fuel dealers and related services companies located throughout Maine, New Hampshire, Vermont, Massachusetts, Connecticut and Rhode Island. NEFI member companies deliver 40 percent of the nation's home heating oil, and many also market bioheat, biodiesel, propane, kerosene, jet fuel, diesel fuel and gasoline.

I am Co-Owner and President of one of those companies, Cota &Cota, Inc. of Bellows Falls, Vermont. Cota & Cota is a third generation family-owned and operated home heating fuel provider in southern Vermont and western New Hampshire and has helped to keep New Englanders warm for over 60 years. Unlike larger energy companies, heating fuels dealers like me are mostly small, second and third generation family-run businesses. Also unlike larger energy companies, we deliver heating fuel *directly* to American homes and small businesses, and therefore have developed close relationships with our customers, their families, and our local communities.

Just to give you an idea of the size of heating fuel providers, the average heating fuel dealer has approximately 4,016 heating oil customers and delivers approximately 3.3 million gallons per year, and those selling propane average about 1,900 customers and 789,000 gallons per year. Most companies are small, many family owned, and most full service fuel companies average just over thirty employees.[1] In a joint NEFI-PMAA member survey of heating fuel providers earlier this year, excessive volatility and the need for greater transparency and accountability in the energy commodity markets ranked as the number one public policy concern for our member companies.

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[1] Information courtesy the "2006 Oilheat Survey," Gray Gray & Gray,LLP, Westwood, MA, 2006.

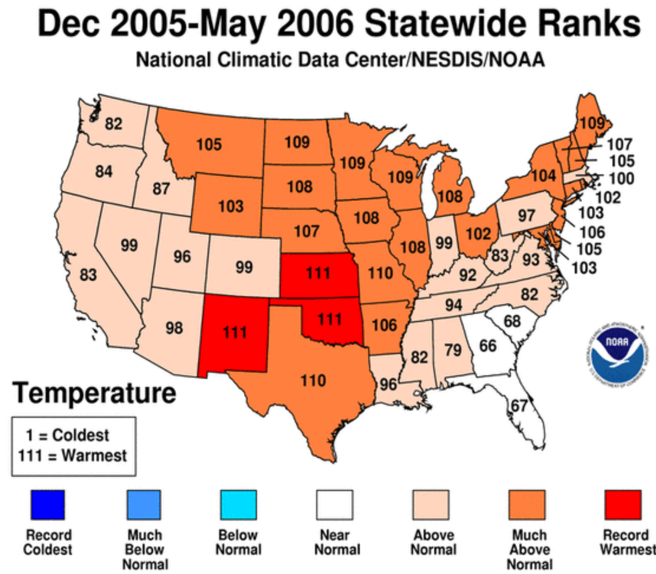
Energy consumers are affected by excessive speculation and price volatility in the energy commodity markets in profound ways. When excessive speculation and volatility result in astronomical prices for gasoline and other motor vehicle fuels, Americans can simply choose not to fuel their car or truck. This may have devastating consequences for our nation's economy, businesses, and lifestyle. But when heating oil, natural gas and other heating fuels skyrocket to unprecedented levels, it places at risk the health and welfare of Americans families – especially low income and elderly households – who rely on these products to heat their homes and keep warm. Additionally, unexpected spikes in heating fuel prices can strain the credit lines of small business fuel dealers (and their lenders), and make it more difficult for them to buy the fuel they need, when they need it. According to NEFI estimates, market conditions have increased the credit requirements of heating oil dealers three-fold in the past ten years as the cost of fuel to the dealers has risen and consumer ability to pay within terms has declined.

We and our customers need our public officials, including those in Congress and on the Commodity Futures Trading Commission (CFTC), to look after us and take a stand against profiteering traders and hedge fund managers that seek to artificially inflate prices for their own personal gain. We deserve to be made aware – in fact we deserve to know - the truth behind what is driving these prices, especially pertinent market forces that might be contributing to volatility and price spikes.

In the winter of 2005-2006, much of the country, especially in the Northeast, the National Oceanic and Atmospheric Administration (NOAA) reported state average temperatures in

the coldest regions of the nation running significantly higher than normal (figure 1, below).

Figure 1



Additionally, the Energy Information Administration repeatedly reported that national stocks of distillate fuel oil remained high as a result of the decreased demand due to the warm weather. However, despite the warm weather, decreased demand and high inventories of these fuels, heating oil prices remained high, with New York Harbor spot prices averaging $1.82 per gallon throughout the season.[2] In an effort to find the cause of this anomaly, the New England Fuel Institute commissioned a study to find the root cause of the market's strange behavior in light of these facts. However they ran up against a wall because of the inability to gather the data needed on over-the-counter trades, upon which a majority of price setting activities occur. Without this valuable information, the report remained incomplete.

[2] "New York Harbor No. 2 Heating Oil Spot Prices History," Department of Energy, Energy Information Administration.

The reason, we were surprised to find out, was that the principle regulatory body responsible for collecting data and policing the energy commodity markets, the CFTC, was not collecting the data due to a series of legislative and regulatory loopholes exempting over-the-counter exchanges and foreign boards of trade with U.S. destined contracts from federal oversight.[3] It is upon these "Dark Exchanges" that traders may be tempted to engage in dubious and manipulative trading practice, free from the reach of U.S. regulators.

Do not be mistaken. We do not oppose the free exchange of commodity futures on open, well regulated and transparent exchanges that are subject to the rule of law and accountability. In my own company, for example, I rely on these markets to hedge my product for the benefit of my consumers. In an effort to protect my customer against roller-coaster-like price volatility on the energy commodity exchanges, I engage in hedging activities.

My Grandparents began our company and serving the community with heating fuels in 1941. We have been offering fixed price programs to our customers for the past two decades. At first, we filled our fuel storage in the summertime and sold those gallons to our customers until we ran out of those gallons. However, my storage, although large by industry standards, is still very limited. We have available six days of January supply in storage capacity.

[3] These "legislative and regulatory loopholes" were outlined by this committee in last year's extensive and bipartisan report on excessive speculation in the energy commodity markets, "The Role of Market Speculation in Rising Oil and Gas Prices: A Need to Put the Cop Back on the Beat," June 27, 2006.

It quickly became apparent, due to customer demand, that we would need a different method of providing fixed price programs. It was at that time that we began to enter into New York Mercantile Exchange (NYMEX) based futures contracts with our suppliers so that we could continue to offer these programs to our customers. These independent suppliers of wholesale fuels would purchase NYMEX contracts for future delivery and, in turn, resell these contracts to me after a profit was added. This is the current system in which we continue to financially hedge heating fuels for our customers. This is typical for the industry.

Because heating demand is a bell curve where January is much colder than other months, customers buy a single annual contract from me while I, in turn, purchase ten NYMEX monthly contracts to match temperature and demand. Because my minimum hedge is ten contracts, or 420,000 gallons, with the typical customer purchasing 900 gallons per year, I hedge for approximately 450 customers at a time.

There have been significant changes in the behavior of the market since we first began purchasing NYMEX based contracts, the largest of which is market volatility. Traditionally, when we purchased futures contracts the coldest winter month, January, was more expensive than the warmest summer month of August. The rate of difference was usually something slightly larger than the interest cost of money. The past few years we have seen the difference between the summer months and the winter month, ("contango" or "carry") be as high as 23 cents per gallon.

Up until about four years ago, it would have been abnormal to have a daily move in the market of larger than one half (1/2) of a cent. Today it is typical to see five cent daily moves and moves as high as 12 cents. In recent years we have witnessed energy market moves of more than one dollar per gallon. We use to offer insurance programs as an alternative to fixed pricing for our customers. These "option-" based programs have had the highest increase in volatility. Four years ago we were able to purchase an "at the money," "put" and "call" at a reasonable cost for our customers. This transaction would enable customers to be protected if prices went up or down from the current price. Four years ago my cost on this type of transaction for a January contract purchased in the summer would have been between 4 and 6 cents per gallon. Today that same program would cost me in the area of 40 cents per gallon. We have seen it as high as 50 cents per gallon.

Currently, these fixed price programs make up 70 percent of my total sales, approximately 65 percent of which is heating oil, 30 percent is propane, and five percent home heating kerosene. In a business that makes profit in cents per gallon, these are some of the reasons why it is much more difficult to continue to provide these fixed price programs to our customers. Unlike many players in the market, who make these commodity investments for pure financial gain, we, as an industry, are hedging directly for consumers. Consumers are being injured by these huge financial players speculating on the market.

The annual heating oil industry volume for U.S. consumption is approximately 8 to 10 billion gallons per year. With ICE, NYMEX, other exchanges and derivative deals, I would not be surprised if the annual consumption is traded several times per day. Speculators are important in our market; without them we would not be able to hedge future demand for our consumers. But with huge hedge funds and other speculators entering into the market, sometimes it seems to have the effect of an "elephant jumping into the bathtub."

The collapse of the Amaranth natural gas positions in August of last year is but one piece of a broader problem. My company and my customers are no longer subject to the market fundamentals that drove price discovery functions on the commodity markets in years past. American consumers and small businesses should be put on alert that prices are now set by greed and fear and manipulation on energy markets that are completely free of government oversight and accountability. This is the new reality of the world we live in, and this is real "price gouging" on a global scale.

The Dark Exchanges are increasing in both number and reach. On June 1, 2007, the New York Mercantile Exchange opened a Dubai-based Mercantile Exchange and launched an Oman crude oil futures contract. The CFTC was quick to issue a "no-action letter" exempting the exchange from its oversight rules.[4] And just a few weeks ago, the Atlanta-based (but U.K.-regulated) InterContinental Exchange (ICE) purchased "ChemConnect," owner of the "Chalk Board," an electronic trading platform, thus virtually adding an array

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[4] http://www.cftc.gov/files/tm/letters/07letters/tm07-06.pdf (Accessed June 20, 2007)

of vital commodities, including propane, butane, and ethanol to its portfolio overnight.[5] Members of the Committee will recall that ChemConnect is the platform upon which the CFTC last year accused BP of manipulating TET propane prices in the winter of 2004.[6] A potential increase in futures prices and volatility for propane, as a result of this transaction, is of concern to me because propane constitutes a significant portion of my business.

Congress and enforcement authorities need to act now and reign in excessive speculation and out of control profiteering on the energy commodity markets. They need to show their constituents that they are serious about shining light on the Dark Exchanges.

We recommend that Congress take the following actions…

(1) Encourage the CFTC to revisit its use of "no-action" letters, which virtually exempt foreign boards of trade that allow electronic U.S. access to their platforms.

(2) Investigate whether or not the Atlanta-based ICE intentionally established its operations in London to circumvent U.S. regulation.

(3) Require that large position data collection requirements for all U.S. destined contracts of commodities essential to the health and welfare of American citizens, including heating oil, propane, and natural gas.

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[5] "ICE Buys Commodity Unit of ChemConnect," by Jeremy Grant, MSNBC, June 4, 2007. <http://www.msnbc.msn.com/id/19033516> (Accessed June 20, 2007)

[6] "U.S. Commodity Futures Trading Commission Charges BP Products North America, Inc. with Cornering the Propane Market and Manipulating the Price of Propane," CFTC Press Release, Washington DC, June 28, 2006.

(4) Fully fund the CFTC to levels appropriate to upgrade infrastructure, data collecting capabilities and to meet necessary personnel requirements.

(5) Encourage the CFTC to be more vigilant in its enforcement of its own data collection requirements and hold the Dark Exchanges to the same rule of law that is expected of Designated Contract Markets such as the NYMEX and the Chicago Mercantile Exchange (CME).

(6) Continue to hold energy exchanges, financial firms, market traders and hedge fund managers to account; continue to conduct hearings and collect information in the years to come; and moreover, make every effort to educate your constituency – U.S. public – on the truth of this issue.

I thank you again, Mr. Chairman, for this opportunity to share my insight into this issue. I am open to any questions that you might have.