Testimony of
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Independent Connecticut Petroleum Association
and the New England Fuel Institute

Before the
United States House of Representatives
Committee on Energy & Commerce
Subcommittee for Oversight & Investigations

Washington, DC
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Honorable Chairman Stupak, Ranking Member Shimkus and distinguished members of the committee, thank you for the invitation to testify before you today on the issue of speculation and alleged manipulation in the energy commodities markets, and its impact on independent, small business energy distributors and their customers.

About NEFI & ICPA

I testify before you today as Executive Director of the Independent Connecticut Petroleum Association[1]. Our association was formed in 1950 and represents 549 independent, locally owned and operated motor fuels and heating fuels distributors in Connecticut that serve 682,000 heating consumers.

I also testify on behalf of the New England Fuel Institute (NEFI)[2], a 60-year-old trade group and public policy advocate representing well over 1,000 heating fuel dealers and related services companies in the Northeastern United States. NEFI member companies market heating oil, bioheat, propane, kerosene, biodiesel, jet fuel, off-road diesel and motor vehicle fuels.

[1] Official website www.icpa.org
[2] Official website www.nefi.com.

“Black Friday” Proves Excessive Speculation No Longer A Myth

On Friday, June 6th, the day that my industry is now calling oil trading “Black Friday,” crude oil hit an all-time record of $139.12. Heating oil and gasoline closed at new highs of $3.98 and $3.55, respectively. Trading that day was at unprecedented volumes as well as prices. 1.09 billion barrels of crude oil were traded that day, 53 times daily U.S. consumption. Also that day, 99 million barrels of heating oil were traded, *half of total U.S. consumption per year.* Mr. Chairman, we are no longer confident that the markets are doing their job of providing our industry and consumers with a benchmark for pricing product that is based on economic dynamics of supply and demand, and they no longer function as a risk management tool. They have become completely disconnected from reality. Is excessive speculation a reality? The events of June 6th have shattered all doubt.

Americans all over the country are joining us in this debate. Millions of people around the world are being priced out of the vital consumables that they rely on each and every day to feed their families, get to work and heat their homes. It is the latter of these struggles that has my industry gravely concerned. Consumers are watching food prices skyrocket, while grocery store shelves remain stocked. They see once unthinkable prices at the pump without the long lines at gasoline stations experienced during the oil embargoes of the 1970s. The “sticker shock” experienced by home heating customers on receipt of their oil or gas bill begs the question of their utility company or dealer, “are you running low on supply?” The answer of course is, “no.” No, we are not running out of energy. Or food. Yet, millions of Americans, especially low income and middle class Americans, are made subject to a roller coaster ride of speculative excess that favors not the small heating oil company or gasoline station owner, but rather the financially-driven non-physical commodities market trader.

How do you explain a rise in crude oil from 50 dollars to nearly 140 over just 16 months? One need not be an economist to accurately observe that there was no tripling of demand or sudden shock in supply, especially not in our industry. The role of the financial community is more clear.

- America's financial institutions have an estimated $260 billion invested in energy commodities now, up from $13 billion in 2002 – a staggering 1,900% increase. During this same time crude oil's price has increased 600%
- According to the Bank for International Settlements, as of 31st December 2007, the total amount of OTC commodity contracts outstanding came to $9 trillion – up from $7.1 trillion the previous year, bringing a total of $1.9 trillion of new investments into commodity derivatives during 2007.
- Let's assume that oil represents about 70% of those contracts, which seems like a fair assumption given that oil is about 70% of the major commodity indices. 70% of $1.9 trillion is about $1.33 trillion. Even if we assume that all those commodity contracts used zero leverage (which is most likely not true), such an amount of money going into the oil market in a single year is certainly enough to move prices.

My fellow witnesses today will explain to you how much speculation is playing a role in the markets and whether or not traders are "gaming" or manipulating the system. Mr. Chairman, I am no trade expert, but as a representative of small businesses heating fuel dealers, I am able offer you expertise on the effect that this speculative fervor has had on our members and their customers, and what it could mean for home heating in the upcoming winter.

The Effect on Small Businesses Petroleum Marketers

Petroleum marketers, like other small businesses, are required to secure lines of credit with a bank and supplier in order to purchase the product their retail consumers' demand. In the current environment, the doubling in price of motor and heating fuels over the last 16 months has forced these marketers to request a two-fold in their credit lines – and many are being denied. All the while, cash flow is slow to come in from customer receivables, especially from low income heating oil customers that have exhausted their fuel assistance money and are feeling the overall pressure of a slowing economy. **The average 2.5 million gallon heating oil company in our state that had to capitalize $1,150,000 for wholesale oil in 98/99 is looking at $9,125,000 in 08/09. That same company sells 20% of their annual volume in January [500,000 gals], and will need $2 million in credit to purchase oil on 10 or 30 day terms and wait 30-45-60 days to be paid by consumers, or longer. $2 million in credit for one month.**

Small, independent gasoline, diesel fuel and heating oil dealers continue to hold out hope that Government will act soon to mitigate the speculative bonanza in the futures markets, but they must look to their public officials for a more immediate solution to the "credit crunch" they are currently experiencing. These people need access to the credit required to purchase gasoline, heating oil and other essential fuels in order to meet the needs of their customers, and in the current environment many struggle to do so.

With high prices come high call volumes from customers looking for an explanation. Retail gasoline and heating oil dealers and their employees have had to explain the unexplainable, and difficult to explain volatility in the energy markets to their customers. Additionally, retail heating oil dealers have had to increase their customer communications efforts in order to stave off unwarranted negative public relations regarding the image of "oil" and the misperception that retail heating oil dealers are "gouging or amassing vast profits like the major oil companies.

These informative efforts seem to be paying off, and the public is finally starting to come around. In a Gallup Poll published earlier this month, when asked "who's to blame" for rising energy costs, the public pointed to Wall Street speculators at 30 percent, up from six percent just two weeks prior- they were tied with Congress for the number one spot. The American public is now looking to this Congress to act, and to act decisively, as are our member companies and other small business around the country. The companies are struggling to remain competitive and to provide the quality products and services our economy depends on – the very things that have made this country a world leader.

I am also pleased to announce that my industry, lead by the New England Fuel Institute and the Petroleum Marketers Association of America, is spearheading a massive consumer outreach campaign called "StopOilSpeculators.com." Independent energy distributors, including heating fuel dealers and gasoline station owners and operators, will disseminate print materials explaining the role opaque and unregulated commodities trading plays in the sky-high prices they now face. Consumers will be given an opportunity to write Congress and urge immediate action. A similar campaign in the New England, New Jersey and New York State region earlier this year produced over 50,000 messages to Congress. By widening this campaign to all fifty states, all members of this Congress will be hearing more from their constituents very soon.

Public Policy Solutions

So what can Congress do to help solve the problem? Many policies currently being touted on both sides of the isle seek to address the unprecedented run-up in energy prices. But these proposed initiatives miss the mark because they assume that prices are tied to a shortage of supply and an increase in demand. They assume that by increasing supply or by moving to alternatives- thereby reducing demand- their proposals will have a real and tangible effect on the market and, consequently, consumer prices.

Proponents of alternative energy are using the current environment to justify a quick and progressive advance toward an array of "renewable" and "sustainable" energy sources. Our industry agrees that alternatives must be developed in order to reduce our dependence on foreign oil and provide cost-effective alternatives to fossil fuels. However, to do so without correcting the opaque nature of the futures market could subject these emerging energy sources to the same volatility and speculation that today afflicts conventional fossil fuels and other commodities.

Alternatively, others on Capitol Hill have called for a quick lifting of the ban on off-shore drilling and in other areas with bans on oil recovery, such as the Arctic National Wildlife Refuge. Our industry supports and endorses proposals to increase domestic production of oil through both conventional means such as drilling and unconventional means such as coal-to-liquids technology. However, increasing domestic supply of oil will have little or no impact on the speculative price of a barrel of oil because these markets have become dislocated from supply and demand economics. For example, OPEC has repeatedly submitted that its attempts to increase production have fallen on the deaf ears of the speculator, and have thus translated to little or no global price relief.

Congress must move quickly and assertively to address dysfunction within the markets by:

1. implementing across-the-board transparency and accountability requirements on all energy trading environments, all market participants and for all sizes of positions held by closing the so-called "London," "Dubai" and "Swap Trader" loopholes;
2. substantially reducing speculation limits and raising margin requirements for all energy commodities;
3. setting aggregate position limits based on positions held in all trading environments and mechanisms;
4. substantially reducing the role non-commercial energy complex investors play in buying paper contracts where these players cannot and do not ultimately accept delivery of the physical energy being traded on paper;

5. implementing tough new financial consequences and mandatory jail sentences for market manipulators;
6. pressuring the CFTC to aggressively enforce existing and future authorities; and
7. doubling CFTC funding in order to provide it with the personnel and resources it needs to effectively monitor the markets to insure the are stable, function and that all trading is subject to the rule of law.

Opponents to greater transparency and regulation argue that such measures will bring about an "exodus" to off-shore trading environments. First of all, such a statement implies that there is some sort of unethical or abusive trading occurring that one would wish to take off-shore in the first place. Second, if these phenomena were to be a real consequence of fully transparent and accountable U.S. markets, and trading was to move off-shore, we must follow it. U.S. authorities should lead the way in establishing a new and international monitoring regime, and they should work to develop new relationships with overseas regulatory agencies. **The President should make this a priority issue and engage with other G8 leaders on this issue when the meet in Japan next month.**

Finally, we hope that Congress will take a look at the heating oil contract on the New York Mercantile Exchange, or NYMEX. When the contract was created by NYMEX in 1978, heating oil consumption was much greater than diesel consumption, and therefore was used as a principle proxy for diesel fuel and other distillates. Today, even though diesel fuel consumption volumes have well surpassed heating oil consumption volumes, diesel and jet fuel is still hedged off of the NYMEX heating oil contract. As a result, heating oil may be forced to ride the increasing domestic and foreign demand for diesel fuel. This would explain the spring and early summer spikes in heating oil prices that our industry is seeing, despite a bottoming out of domestic heating oil demand. **Congress should work with heating oil industry leaders and experts to determine whether or not diesel fuel and heating oil contracts should be separate NYMEX offerings.**

Thank you again, Mr. Chairman, for this opportunity to share my insight on this issue. I commend you and your colleagues in this committee for looking hard at this issue, and for championing public policy solutions that will help to insure transparent, accountable and stable commodities futures markets. I am open to any questions that you might have.

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Summary of Main Points
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- Excessive speculation is very real, as evidenced by the run-up in commodity prices in the past 16-months and, more recently, the events of "Black Friday," June 6th.

- American consumers are the hardest hit by this speculative fervor. Consumers are acknowledging the role of speculation, and are demanding action by Congress and federal authorities at the CFTC.

- Small businesses are also hit hard, especially small business motor fuel and heating fuel companies. Fuel dealers have experienced a strain in cash flow due to consumer financial hardship, and their credit lines are not increasing proportionate to the increase in prices – making it more difficult to obtain the product they need, when the need it.

- The petroleum marketing industry has announced a major grassroots campaign, stopoilspeculatorsc.com, to educate consumers on the role of speculation in increased gasoline, diesel fuel, heating oil and other energy prices.

- Congress should pass laws or place appropriate pressure on the CFTC to increase close the "London," "Dubai" and "Swaps" loopholes, and to insure full transparency and anti-manipulation rules on all trading activities and environments.

- The administration needs to engage word leaders and regulators in a new global commodities trading regime, and this conversation should start at the G8 in July.

- The NYMEX heating oil contract, which is used to hedge diesel fuel and jet fuel, may need to be split to offer two different contracts.