STATEMENT OF

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BEFORE THE

SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

CONCERNING

"EXCESSIVE SPECULATION IN THE NATURAL GAS MARKET"

PRESENTED ON JUNE 25, 2007

Shane Lee

Senate Committee on Homeland Security and Governmental Affairs

Permanent Subcommittee on Investigations

"Excessive Speculation in the Natural Gas Market"

June 25, 2007

Chairman Levin, Ranking Member Coleman, thank you for the opportunity to appear here to discuss some of the issues that the Permanent Subcommittee on Investigations (the "Subcommittee") is considering in this hearing. I am appearing here voluntarily, and I have previously provided information to the Subcommittee Staff in connection with its investigation.

I have been trading energy products since 1998, including NYMEX strategies, locational trades (basis) and options, and I have experience as both a financial and physical trader. I began working as a trader at Amaranth Advisors (Calgary) ULC (collectively, with Amaranth Advisors LLC, "Amaranth") in April 2006. I was based in an office in Calgary, Canada, rather than at Amaranth's headquarters in Greenwich, Connecticut. Amaranth was a hedge fund that invested in a variety of investment strategies, including energy trades. In particular, in 2006, Amaranth's natural gas portfolio consisted of futures contracts, financially-settled swaps, and options positions based on various strategies. Amaranth never took or made delivery of physical natural gas. In September 2006, Amaranth suffered dramatic losses and is now out of business. I left Amaranth in September 2006.

I traded my own portfolio at Amaranth, consisting of locational markets (basis), NYMEX futures/swaps and options. Although I sometimes traded significant volume for my own portfolio at Amaranth, this represented only a small portion of Amaranth's overall natural gas portfolio. I was one of numerous members of the natural gas team at Amaranth. I did not meet any Amaranth investors and I did not have any authority over risk management. During the summer of 2006, from time to time, I also executed trades for Brian Hunter, another energy trader at Amaranth.

The Subcommittee has requested that I address particular matters to assist its understanding of the issues in the present investigation. In this Statement, I offer my views, from my perspective as a trader, on the following issues: (1) my experience as a natural gas trader in 2006; (2) whether Amaranth engaged in so-called "excessive speculation;" (3) whether Amaranth dominated the natural gas market; (4) whether NYMEX futures and ICE natural gas swaps are comparable products; (5) what actions Amaranth took in August 2006 in response to a directive from NYMEX to reduce its natural gas positions; and (6) whether new statutory or regulatory provisions are required for ICE.

In response to the Subcommittee's request for my experience trading in the natural gas markets in 2006, I offer the following observations. Price levels in 2006 were generally higher than earlier in the decade, as they were in most energy commodities, although natural gas prices had fallen from higher peak levels in 2005. In my view, the reasons for those higher price levels in 2006 were fundamental factors such as higher crude oil and crude oil products prices, coal prices, perceived hurricane risks (whether warranted or not) and general demand growth. Similarly, there were periods of extreme volatility in 2006, which appeared to have been caused by such fundamental factors as hurricane scares, extreme heat in late July and early August 2006 and the unusually warm winter of 2005. There were also periods in 2006 when prices went below prior levels because of historically high natural gas storage levels.

Was Amaranth engaged in "excessive speculation"? Because Amaranth was not a producer or user of natural gas, and did not engage in physical delivery, its trading was by definition "speculative." Amaranth's trading volume was large in comparison to my own prior trading experience at other companies. But I did not consider Amaranth's trading to be "excessive." The information available to market participants regarding the size of the overall market is incomplete and limited to "snapshots" of open interest on the NYMEX futures market. Because of that lack of information, I did not know exactly how Amaranth's positions compared to the size of the overall market. However, I understood that other market participants engaged in trading that was comparable in size to that of Amaranth.

Although I believe that, like any market participant, Amaranth's positions were reflected in short-term price changes, I do not believe that Amaranth's trading dominated the natural gas market. I also do not believe that Amaranth's trading on unregulated exchanges contributed to any price distortions. The exchanges in question are high-volume, extremely liquid markets, which are capable of absorbing transactions of the size of Amaranth's trading.

The Subcommittee has requested that I provide information on whether natural gas futures contracts on NYMEX and natural gas swaps on ICE are comparable products. Although futures contracts and swaps are similar, there are fundamental differences. The principal difference is that futures contracts require the holder to make or take physical delivery unless the position is exited before it expires, while a swap is financially settled and the holder is not required to make or take physical delivery. The markets for futures contracts and swaps behave similarly until the settlement period when they can diverge. During the settlement period, the price of a futures contract can be extremely volatile, and the price of the swap contract tends to decline in volatility during the settlement period as confidence increases in the settlement price.

I generally preferred swaps on ICE to futures contracts on NYMEX because swaps do not require physical delivery. Amaranth never took physical delivery. Other reasons for using ICE are the greater level of confidentiality (that is, the lower risk that one's position will be revealed to competing traders), the often greater liquidity and lower execution prices, and the differing margin requirements.

The Subcommittee has also requested that I address what actions Amaranth took in August 2006 in response to the directive from NYMEX to reduce its position in the natural gas futures market. It is my understanding that on August 29, 2006, the NYMEX contacted Amaranth's Compliance Director to request that Amaranth reduce its September 2006 natural gas position and not trade that position during the settlement period. Amaranth advised the energy trading desk, which in turn exited its positions in the September 2006 futures contract prior to the settlement period. I had little or no knowledge of, or involvement in, Amaranth's response to that directive.

In addition, the Subcommittee has requested my views on whether trading on NYMEX and ICE should be subject to the same position limits and treated the same. As a trader, I am familiar with position limits on NYMEX and abide by those limits. In general, limits can have costs and benefits to traders and other market participants. As a trader, rather than a policymaker, I do not have strong views on whether position limits should be imposed on other exchanges. I do think that any such position limits should be confined to products that are identical, from a risk perspective, to futures.

Finally, the Subcommittee has requested that I address whether ICE should be subject to the same statutory and regulatory provisions as the regulated exchanges. Implementing accountability and reporting requirements on ICE would impose administrative burdens on OTC participants and ICE. However, such measures would increase transparency, allow hedge funds and other traders to monitor the amount of open interest, and help deter any potentially improper conduct.

Once again, I thank the Subcommittee for the opportunity to appear and discuss some of the issues that it is considering.