

**TESTIMONY OF PAUL CICIO
INDUSTRIAL ENERGY CONSUMERS OF AMERICA
BEFORE THE
U.S. HOUSE AGRICULTURE SUBCOMMITTEE ON GENERAL FARM
COMMODITIES AND RISK MANAGEMENT
“TRADING OF ENERGY BASED DERIVATIVES”
JULY 12, 2007**

Chairman Etheridge and Ranking Member Moran, thank you for the opportunity to testify before this subcommittee on the important issue of trading of energy-based derivatives.

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 energy markets are working fairly, without manipulation and operating with a level playing field. Nothing could be further from the truth.

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 June 2007 U.S. Senate Permanent Subcommittee on Investigations report entitled “Excessive Speculation in the Natural Gas Market” confirms that Amaranth controlled 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. We strongly encourage each member of Congress to read the Senate report that provides a startling reality check on how markets are being manipulated.

Amaranth provides a clear and troubling picture of how easy it is for large hedge fund and Wall Street trading companies to manipulate the market to the benefit of their investors and to the detriment of every consumer in this country. Amaranth completely dispels the Wall Street myth that the market is too large for any one company to manipulate.

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 on NYMEX, the Inter Continental Exchange (ICE) and other Over the Counter (OTC) markets. Today, under existing law, regulators can only monitor trading volumes on NYMEX.

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.

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 higher price of natural gas is increasing the price of electricity across the country.

For example, natural gas represents 85% of the cost of making anhydrous ammonia 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 natural gas 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 the Over the Counter Markets (OTC) including 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 reduce excessive speculation and make sure that market power and market manipulation does not occur.

The Amaranth event raises several important questions for Congress to address. The CFTC has known for a long time that a significant market oversight gap exists. Why hasn't the Chairman of the CFTC stepped forward to say there is a problem? Why isn't the CFTC responsive and accountable to the public interest? Did the Commodity Futures Modernization Act (CFMA) of 2000 go too far and did it weaken CFTC's market oversight accountability? Is the relationship between the CFTC and the exchanges too cozy? Why are there not time limits that prevent CFTC officials from taking top positions with the exchanges?

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 Congress take immediate action to give CFTC regulatory oversight of ICE and other Over the Counter markets; require large traders to report their positions daily to CFTC; give CFTC the ability to aggregate positions regardless of where they are held; establish daily volume trading limits; increase monitoring in all months, not just near term months; increase CFTC funding for monitoring and enforcement; and lastly, increase the supply of natural gas.

Asking OTC ‘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 financial management reasons anyway. Plus, it is safe to say that the same companies who are reporting to CFTC thru NYMEX are the same companies who are not reporting thru ICE. Reporting large positions to the CFTC is not asking much when the public trust is at stake.

Thank you.