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**Testimony before the
United States Senate
Committee on Energy & Natural Resources**

**Washington, DC
April 3, 2008**

Honorable Chairman Bingaman, Ranking Member Domenici and distinguished members of the committee, thank you for the invitation to testify before you today. As both a petroleum marketer and as a representative of two respected trade groups that together represent our nation's independent motor vehicle and heating fuel dealers, I appreciate the opportunity to provide you with our insight on the extreme volatility and record setting prices seen in recent months on the energy commodity markets.

I serve on the Petroleum Marketers Association of America's (PMAA)¹ Executive Committee and serve as PMAA's Brands Director. PMAA is a national federation of 46 states and regional associations representing over 8,000 independent fuel marketers that collectively account for approximately half of the gasoline and nearly all of the distillate fuel consumed by motor vehicles and heating equipment in the United States.

I am also President of the New England Fuel Institute (NEFI)², a 60-year-old trade association representing well over 1,000 heating fuel dealers and related services companies in the Northeastern United States. NEFI member companies deliver over 40 percent of the nation's

¹ Official website www.pmaa.org.

² Official website www.nefi.com.

home heating oil, and many market biodiesel, bioheat, propane, kerosene, jet fuel, off-road diesel and motor vehicle fuels.

And finally, I provide you insight today as co-owner and President of Cota &Cota, Inc. of Bellows Falls, Vermont, a third generation family-owned and operated heating fuel provider in southeastern Vermont and western New Hampshire. My business provides quality home heating fuel to approximately 9,000 homes and businesses. Unlike larger energy companies, most retail fuel dealers are small, family-run businesses. Also unlike larger energy companies, heating oil and propane dealers deliver product directly to the doorstep of American homes and businesses.

Because of this close association with our customers, we have a deep concern for their well being and the general welfare of our communities. Not only do few recognize the small business nature of our retail industry, but few also grasp also our deep commitment to providing the highest quality products at the most affordable and competitive prices. To this end, we have recently proposed an array of measures to policy makers in Washington that can assist our industry in ensuring adequate supply of home heating fuel and insulate the consumer from the currently volatility and excess that dominate the commodities markets.

First, we urge members of this committee and this Congress to support our recent and standing request to the Bush Administration release all 1.97 million barrels of the Northeast Home Heating Oil Reserves. Contrary to statements from the administration, release of product from the reserve need not be tied solely to a crude oil to heating oil differential trigger mechanism.³ Federal law also permits a release from the reserve under discretionary authority provided there

³ 42 U.S.C. 6250b(a)(1)

is a “regional supply shortage of significant scope and duration.”⁴ We are indeed in the midst of such a shortage due to: skyrocketing distillate demand overseas; the steepest decline in refinery runs in over two years; infrastructure limitations and pipeline partitioning due to the current transition to lower sulfur off-road diesel fuel; and declining interest by small bulk plants and terminals to take on high sulfur distillates such as jet fuel and heating oil due to the backwardated market and, as mentioned, the transition to low/ultra-low sulfur diesel. All of these factors will only further exacerbate the already speculation-driven, volatile futures market and record price surges seen in recent months.

Second, we urge on Congress and the administration to implement real and substantial reforms to existing law and federal regulation designed to ensure fully transparent, accountable and stable energy futures markets. For two years now, the New England Fuel Institute, the Petroleum Marketers Association of America, and their various allies in the Energy Market Oversight Coalition have asked for such changes and little has been done. The consequences of inaction are now apparent and will only continue to worsen. For the sake of all Americans and the economy at large, you must act.

It has become apparent that excessive speculation on energy trading facilities is the fuel that is driving this runaway train in crude oil prices. For example, on January 3, 2008, one floor trader bought 1,000 barrels; the smallest amount permitted, and sold it immediately for \$99.40 at a \$600 loss. The trader deliberately pushed the price of a barrel of crude oil over the \$100 just

⁴ 42 U.S.C. 6250b(a)(2)

because he wanted to tell his grandchildren that he was the first person ever to buy crude oil over \$100.⁵

In addition, in times of a national crisis, excessive speculation can also exacerbate an emergency. An example of this comes from a Wall Street Journal article from September 2005, wherein an oil trader bragged about his profits following Hurricane Katrina. This futures trader bragged that some traders made enough money in one week following Katrina that they would not have to work for the rest of the year. Comments like these concern PMAA and NEFI members who argue that the recent volatility in crude oil prices will force small businesses and consumers to pay excessively high energy prices that do not reflect supply and demand factors.

And the rise in crude oil prices in recent weeks which reached \$110.21 on March 13, 2008 has dragged with it every single refined petroleum product, especially heating oil. In just over one month, wholesale heating oil prices from February 11, 2008 – March 18, 2008 have risen from \$2.65 to \$3.31.⁶ The spike comes despite reports by the Energy Information Administration (EIA) that heating oil inventories remain around the five-year average.⁷ Gasoline prices have also risen dramatically reaching as high as \$3.33 on March 17, 2008.

Many heating fuel companies like mine hedge in an effort to protect their customers against roller-coaster-like price volatility on the energy commodity markets. Because of our industry's hedging activities, we strongly support open, transparent and well-managed exchanges subject to

⁵ (BBC News, 2008)

⁶ Energy Information Administration, "U.S. No. 2 Heating Oil Wholesale/Resale Prices," February 11-March 17, 2008

⁷ The EIA reported that U.S. heating oil inventories were to remain within the 5-year average. *See Ibid*, "Short Term Energy Outlook," March 11, 2008.

the rule of law. In fact, it is essential to businesses like mine. My company began offering fixed price programs to our customers twenty years ago. We enter into New York Mercantile Exchange (NYMEX) based futures contracts with our suppliers, who purchase contracts for future delivery and resell these contracts to me for a profit. In this way, companies like mine are able to financially hedge heating fuels for the benefit of the consumer, and help protect them against uncertainty and volatility.

However, the ability of the commodities markets to set a price based on economic fundamentals has become less and less reliable, and as a result, so do our hedging programs. As the influence of price-setting functions on unregulated or under-regulated markets continues to grow, and as trading on over-the-counter and foreign-based exchanges continues to become the norm, American consumers are forced to ride the same speculative roller coaster as the energy trader. For far too long, insufficient oversight and transparency has encouraged excessive speculation and created a trading environment that rewards trading misdeeds, like that of Amaranth Hedge Funds and British Petroleum. “Loopholes” in federal law have created what I call “dark markets,” or energy commodity markets engaging in futures or futures like contracts, swaps and derivatives trades without adequate federal oversight and regulation. Today, a vast majority of trading occurs on these markets.⁸

More specifically, we strongly urge Congress to take swift action to bring light to the “dark markets” by:

⁸ Nearly all experts agree that a majority of trading now occurs off of traditional exchanges like the NYMEX, and some estimate that number to be 75 percent or more.

1. **Closing the notorious “Enron Loophole,”** ripped open by the Commodity Futures Modernization Act (CFMA)⁹ and through which billions of dollars have poured since it was created in 2001. Virtually overnight, the “Enron Loophole” freed all electronic markets from oversight. Congress needs to close the loophole, and close it for all energy commodities, thereby returning to the Commodity Futures Trading Commission (CFTC) the statutory authority that it lost in 2001. As an important first step in closing the Enron Loophole, Congress must: **Pass the Senate version of the CEA Reauthorization Act, included as an amendment to the 2007 Farm Bill, H.R. 2419 is currently in conference. This legislation will reauthorize the CFTC and bring greater transparency and accountability to energy trading facilities through an array of important policy reforms. It is stronger than the CEA Reauthorization language drafted by the Presidential Working Group and currently under consideration in the House Agriculture Committee. Further,** the Senate legislation gained bipartisan support from U.S. Senators Levin (D-MI), Feinstein (D-CA), Chambliss (R-GA), Snowe (R-ME), Cantwell (D-WA), Coleman (R-MN), Conrad (D-ND), Dorgan (D-ND), Lieberman (I-CT), Collins (R-ME), Crapo (R-ID), Durbin (D-IL), and Schumer (D-NY).
2. **Investigating the CFTC’s use of “no-action letters” which we believe equates to a loophole for foreign markets seeing to gamble with American energy commodities and economic interests.** Under the no-action letter process, the CFTC may provide regulatory exemptions under certain conditions to an applicable foreign board of trade (FBOT) offering contracts for delivery within the United States.¹⁰ The current process

⁹ See 7 U.S.C. §2(h)(3), (g) (2006)

¹⁰ See 17 CFR 140.99

may fail to provide sufficient public notice and consultation, and may not take into account the full impact that these letters may have on the market. Moreover, in order to obtain such an exemption, the CFTC requires that a “comparable” regulatory authority be present in the country where the exchange operates. Congress should examine whether or not it determines such regulatory authorities to be “comparable.” And finally, we are concerned that no-action letters may be or have been requested and approved for exchanges seeking to establish electronic platforms overseas with the intent to circumventing U.S. regulatory authority.

3. Reduce the dominance of non-physical players in the commodities markets:

The commodity-related futures markets were primarily created to provide industry participants with a tool to manage inventory and future price related risks. However, our industry’s management tool has been dominated by investment banks and hedge funds that profit from price volatility. This market domination is an extremely significant contributor to high gasoline, natural gas, diesel and heating oil prices. Virtually every commodity has experienced price volatility, reaching record levels from gold to wheat and it seems that there is no end in sight.

Hedge funds and investment banks are not driven to provide U.S. citizens the most affordable energy supplies; they are driven to profit from volatility. PMAA and NEFI believe that margin requirements for speculators who do not have the ability to take physical delivery of their product should be dramatically increased. Futures market officials could impose a physical delivery component for traders to qualify for reduced margins. Earlier this week, Congressman John Larson of Connecticut announced

legislation that would eliminate the commodities markets as an investment tool and return the market to the physical players and consumers that have lost faith in its ability to reflect hard fundamentals.

We realize that there are several different policy recommendations floating around Capitol Hill from an array of sources, including legislators, commission and administration officials, futures trade groups and the commodity exchanges themselves. We ask that your deliberations take in to account all trading environments and all energy commodities, not just the regulation of one commodity at the exclusion of all others.

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

APPENDIX I. CHARTS

You can see in this chart how everything changed in August, as “investment” money from a number of sources started pouring into any and all hard asset categories.

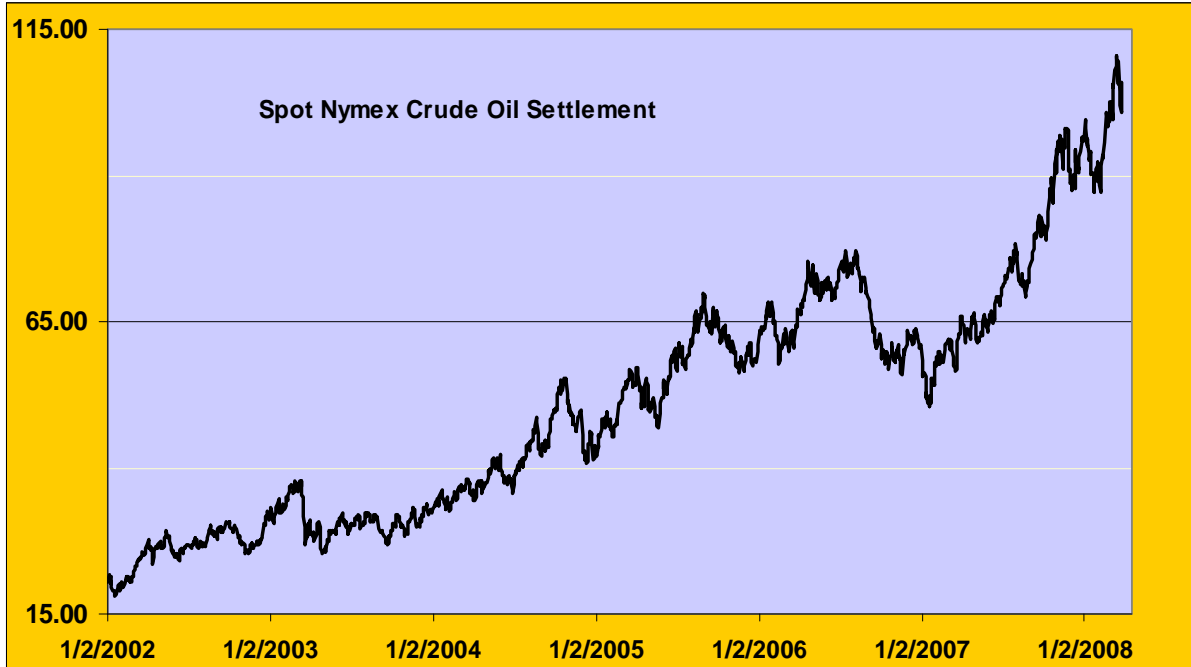


Fig. 1

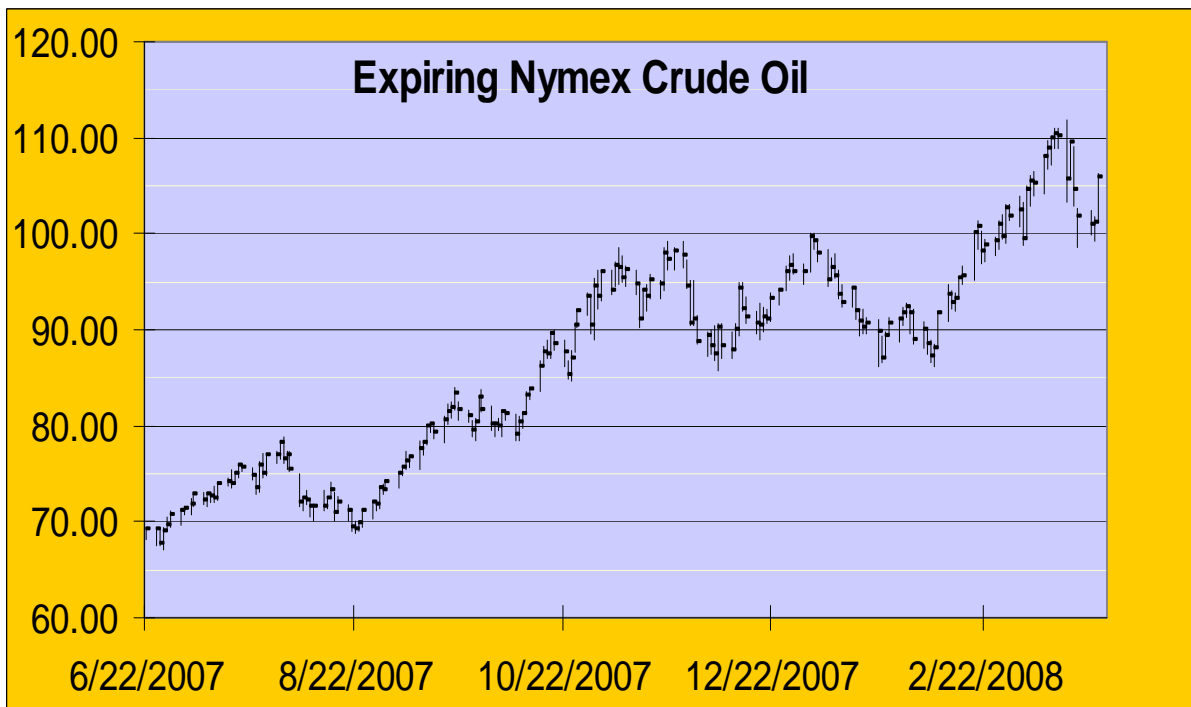


Fig. 2

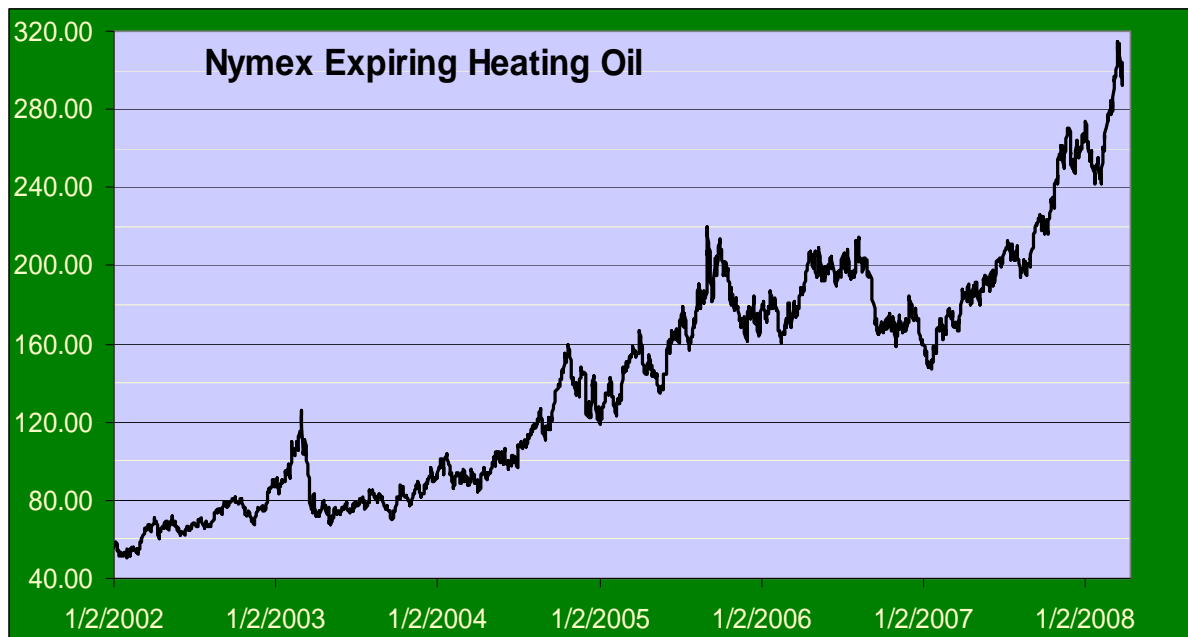


Fig. 3

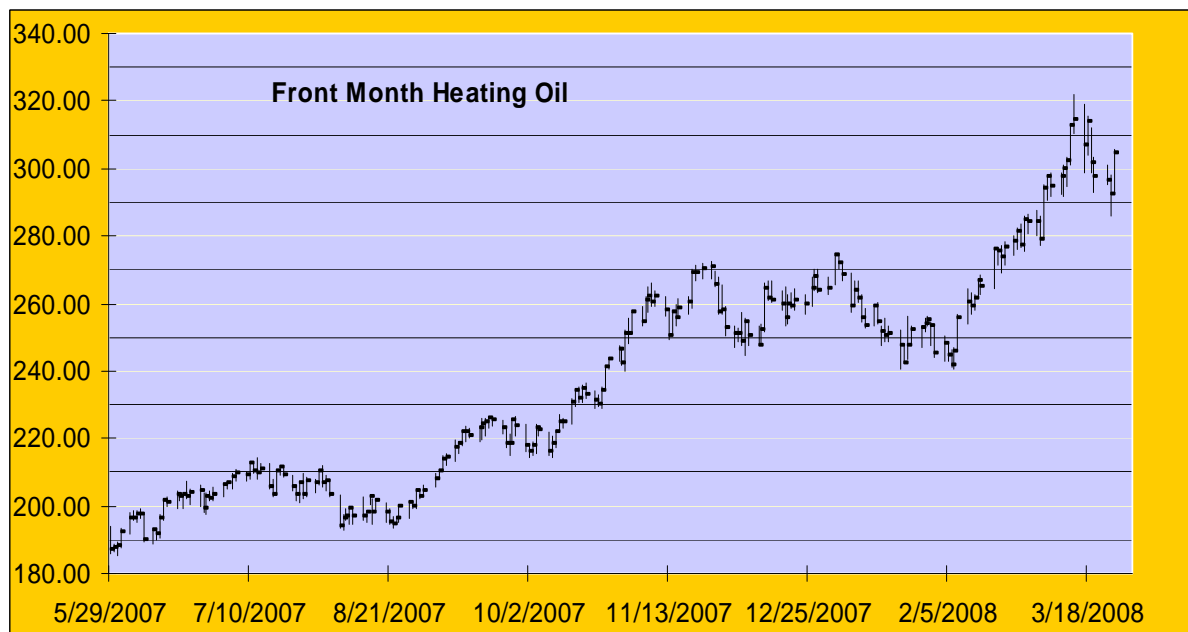


Fig. 4

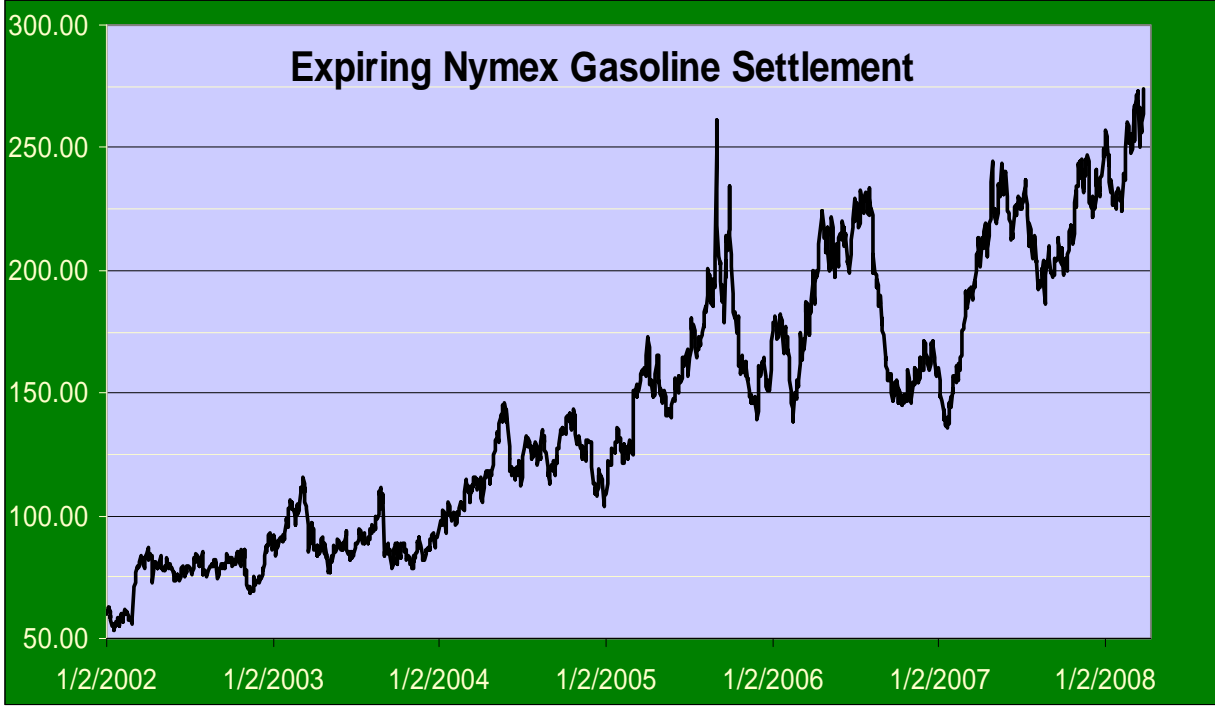


Fig. 5

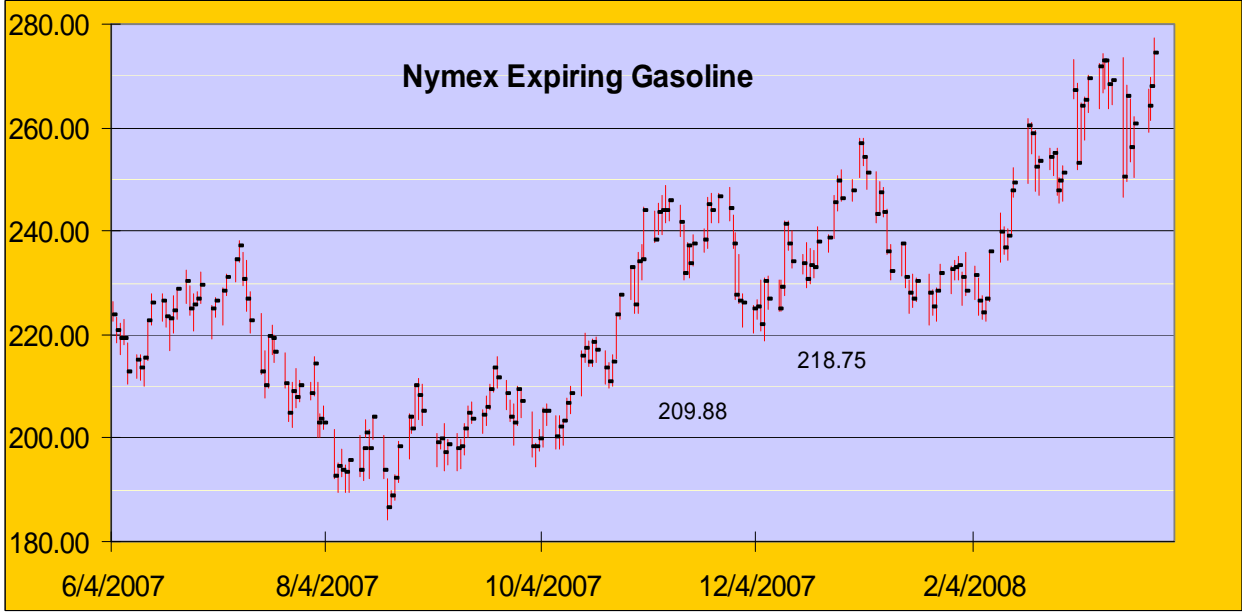


Fig. 6

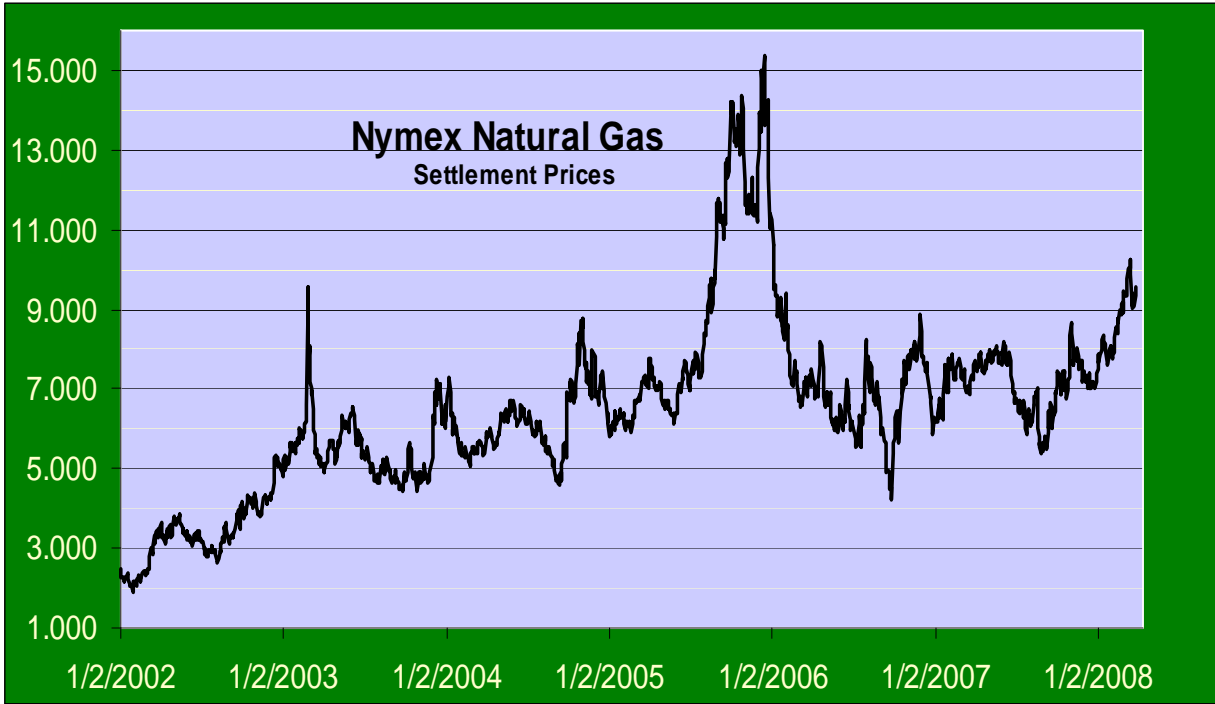


Fig. 7

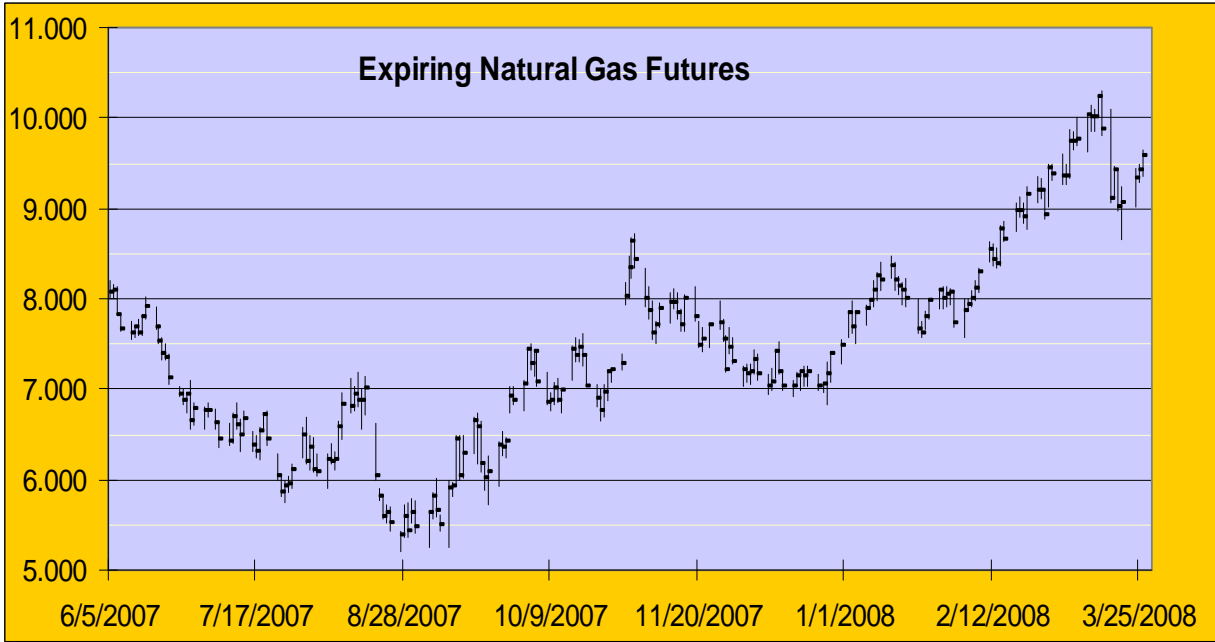


Fig 8

APPENDIX II. QUOTES

Outgoing OPEC president the United Arab Emirates said on Monday that the surge in oil prices to 100 USD a barrel had nothing to do with market fundamentals, the WAM state news agency reported. The surge was because of *'speculation, investment funds (purchases), regional tensions and other factors unrelated to supply and demand'*, it quoted UAE Energy Minister Mohammad bin Dhaen al-Hamli as saying. **Forbes.com, Jan. 7, 2008**

Many analysts believe oil prices aren't justified by crude's underlying supply and demand fundamentals. While supply disruptions in Nigeria and the prospect of a supply cutoff from Iraq and Venezuela helped boost oil prices last year, domestic oil inventories are now rising even as a number of forecasters are cutting their demand growth predictions due to the slowing economy. **Associated Press, March 3, 2008**

Experts, including the former head of Exxon Mobil, say financial speculation in the energy markets has grown so much over the last 30 years that it now adds 20 to 30 percent or more to the price of a barrel of oil. Some of that added cost reflects illegal manipulation, although no one knows how much because so much of the market operates in secret. **New Jersey Star Ledger, Jan. 6, 2008**

The price of oil closed at a record \$102.72 on the NYMEX Thursday. Investors pounced on commodities markets, including oil, as the weakened US dollar encouraged speculators to move to areas with quick price fluctuations. **UPI Business, February 28, 2008**

"We are in the mode where the fundamentals of supply and demand really don't drive the price," Lee R. Raymond, the chairman and chief executive of Exxon Mobil, the world's largest energy company, said at a meeting last week with analysts in New York. "Oil is a commodity, and history tells us that commodity prices never stay high forever." **San Diego Union Tribune, March 15, 2005**

OPEC can do nothing about oil prices that hit a record high of \$100 on Wednesday as the rise is due to geopolitics and speculation and not supply problems, Qatar's oil minister Abdullah Al-Attiyah said on Wednesday. □ "I don't think OPEC can do anything," Al-Attiyah told newswire Reuters by telephone. "If this was related to supply then we could move. But I am confident that it is geopolitics. Speculation has been very strong. It's a game for speculators." **Arabian Business, Jan. 3, 2008**

Consumer advocates and energy dependent businesses getting slammed by higher fuel prices say sophisticated "investors" at hedge funds and investment banks have used these unregulated markets to artificially drive up the price of commodities. "All we're looking for is the same set of ground rules to ensure that there is the same disclosure" across all commodities markets, said Eric DeGesero, executive vice president of the Fuel Merchants Association of New Jersey. **Fox Business News, Jan. 4, 2008**

"As oil prices continue to climb, families in northern Michigan and across the country are being hit hard by rising fuel costs," Stupak said. "People don't mind paying a fair price for a

product, but a price that is being manipulated by speculators is not fair. These high prices are more than just supply and demand.” **Sootoday.com, Jan. 3, 2008, Sault Ste. Marie, Ontario, Canada**

Others analysts blame oil traders for bidding up the price of oil, a process being fed by a weakening dollar, which makes oil cheaper for those buying it with Euros or other currencies that have gained strength against the dollar. "Wall Street greed is pushing the American family and our small businesses to the breaking point," said Shane Sweet, chief executive of the New England Fuel Institute, which represents about 1,000 retailers of heating oil and other fuels. **Washington Post, Jan. 3, 2008**

Oil speculators, for example, have goosed the price well above what is justified by supply and demand. Fadel Gheit, a veteran oil analyst in New York, points out that, historically, oil prices have run roughly triple what it costs to physically extract the crude from the ground. With extraction costs now averaging \$15 to \$18 a barrel globally, Gheit reckons we're paying a "speculative premium" of as much as \$57 a barrel. **Paul Roberts, The Guardian (UK), Jan. 8, 2008**