

Testimony of

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Regarding

Ending Excessive Speculation in Commodity Markets: Legislative Options

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Introduction

My name is Michael Greenberger.

I want to thank the committee for inviting me to testify on the important issue that is the subject of today's hearings.

After 25 years in private legal practice, I served as the Director of the Division of Trading and Markets ("T&M") at the Commodity Futures Trading Commission ("CFTC") from September 1997 to September 1999. In that capacity, I supervised approximately 135 CFTC personnel in CFTC offices in DC, New York, Chicago, and Minneapolis, including lawyers and accountants who were engaged in overseeing the Nation's futures exchanges. During my tenure at the CFTC, I worked extensively on, *inter alia*, regulatory issues concerning exchange traded energy derivatives, the legal status of over-the-counter ("OTC") energy derivatives, and the CFTC authorization of trading of foreign exchange derivative products on computer terminals in the United States.

While at the CFTC, I also served on the Steering Committee of the President's Working Group on Financial Markets ("PWG"). In that capacity, I drafted, or oversaw the drafting of, portions of the April 1999 PWG Report entitled "Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management," which recommended to Congress regulatory actions to be taken in the wake of the near collapse of the Long Term Capital Management (LTCM) hedge fund, including Appendix C to that report which outlined the CFTC's role in responding to that near collapse. As a member of the International Organization of Securities Commissions' ("IOSCO") Hedge Fund Task Force, I also participated in the drafting of the November 1999 report of IOSCO's Technical Committee relating to the LTCM episode: "Hedge Funds and Other Highly Leveraged Institutions."

After a two year stint between 1999 and 2001 as the Principal Deputy Associate Attorney General in the U.S. Department of Justice, I began service as a Professor at the University of Maryland School of Law. At the law school, I have, *inter alia*, focused my attention on futures and OTC derivatives trading, including academic writing and speaking on these subjects. I currently teach a course that I designed entitled "Futures, Options, and Derivatives," in which the United States energy futures trading markets are featured as a case study of the way in which unregulated or poorly regulated futures and derivatives trading cause dysfunctions within those markets and within the U.S. economy as a whole. One result of this dysfunction, as I describe to my students, is the needlessly high prices which energy consumers now pay because of the probability of excessive speculation, illegal manipulation, and fraud within those markets.

The question whether there has been manipulation of U.S. energy futures markets in general, and U.S. delivered crude oil contracts specifically, has been the subject of many hearings. I have previously testified at five of those hearings, the most recent held yesterday before the U.S. House Committee on Energy and Commerce Subcommittee on Oversight and Investigations. To put the issue of today's hearing in context, I summarize and update the relevant points I made at that hearing immediately below.

Summary and Update of Prior Testimony

One of the fundamental purposes of futures contracts is to provide price discovery in the “cash” or “spot” markets. Those selling or buying commodities in the “spot” markets rely on futures prices to judge amounts to charge or pay for the delivery of a commodity.¹ Since their creation in the agricultural context decades ago, it has been widely understood that, unless properly regulated, futures markets are easily subject to distorting the economic fundamentals of price discovery (*i.e.*, cause the paying of unnecessarily higher or lower prices) through excessive speculation, fraud, or manipulation.²

The Commodity Exchange Act (“CEA”) has long been judged to prevent those abuses. Accordingly, *prior* to the hasty and last minute passage of the Commodity Futures Modernization Act of 2000 (“CFMA”), “all futures activity [was] confined by law (and eventually to criminal activity) to [CFTC regulated] exchanges alone.”³ At the behest of Enron, the CFMA authorized the “stunning” change to the CEA to allow the option of trading energy commodities on deregulated “exempt commercial markets,” *i.e.*, exchanges exempt from CFTC, *or any other* federal or state, oversight, thereby rejecting the contrary 1999 advice of the President’s Working Group on Financial Markets, which included the Secretary of the Treasury, the Chairman of the Federal Reserve Board, and the Chairmen of the SEC and CFTC.⁴ This is called the “Enron Loophole.”

Two prominent and detailed bipartisan studies by the Permanent Subcommittee on Investigations’ (“PSI”)⁵ staff represent what is now conventional wisdom: hedge funds, large banks, pension funds, insurance and energy companies, and wealthy individuals have used “exempt commercial energy futures markets” to drive up needlessly the price of energy commodities over what economic fundamentals dictate, adding, for example, what the PSI estimated to be @ \$20-\$30 per barrel to the price of a barrel of crude oil.⁶ At the time of that estimate, the price of crude oil had reached a then record high of \$77. The conclusion that speculation has added a large premium to energy products has been corroborated by many experts, including most recently and most

¹ See Written Testimony of Professor Michael Greenberger, *Energy Speculation: Is Greater Regulation Necessary to Stop Price Manipulation?: Hearing Before the H. Subcomm. on Oversight and Investigations 3-5* (2007), available at http://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1011&context=cong_test (last visited June 21, 2008).

² See, e.g., Jonathan Ira Levy, *Contemplating Delivery: Futures Trading and the Problem of Commodity Exchange in the United States, 1875-1905*, AMERICAN HISTORICAL REVIEW 307 (2006) (“[T]he man who managed or sold or owned those immense wheat fields has not as much to say with the regard to the price of the wheat that some young fellow who stands howling around the Chicago wheat pit could actually sell in a day.”)(quoting *Fictitious Dealings in Agricultural Products: House Comm. on Agric. Committee Hearing Reports* (1892)).

³ PHILIP MCBRIDE JOHNSON & THOMAS LEE HAZEN, DERIVATIVES REGULATION 28 (Cumm. Supp. 2008).

⁴ *Id.*; see also PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, OVER-THE-COUNTER DERIVATIVES MARKETS AND THE COMMODITY EXCHANGE ACT 16 (1999) (“Due to the characteristics of markets for non-financial commodities with finite supplies, however, the Working Group is unanimously recommending that the exclusion [from regulation] not be extended to agreements involving such commodities.”) available at <http://www.ustreas.gov/press/releases/reports/otcact.pdf> (last visited June 21, 2008).

⁵ PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, THE ROLE OF MARKET SPECULATION IN RISING OIL AND GAS PRICES: A NEED TO PUT THE COP BACK ON THE BEAT (June 27, 2006) [hereinafter June 2006 Report]; PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, EXCESSIVE SPECULATION IN THE NATURAL GAS MARKET, (June 25, 2007) [hereinafter June 2007 Report].

⁶ June 2006 Report, *supra* note 5, at 2, 23.

prominently, George Soros,⁷ the International Monetary Fund,⁸ OPEC, and the International Energy Agency.⁹

The PSI staff and others have identified the Intercontinental Exchange (“ICE”) of Atlanta, Georgia, as an unregulated facility upon which considerable exempt energy futures trading is done.¹⁰ For purposes of facilitating exempt natural gas futures, ICE is deemed a U.S. “exempt commercial market” under the Enron Loophole.¹¹ For purposes of its facilitating U.S. WTI crude oil futures, the CFTC, by informal staff action, has deemed ICE to be a U.K. entity not subject to direct CFTC regulation even though ICE maintains U.S. headquarters and trading infrastructure, facilitating, *inter*

⁷ See, e.g., Edmund Conway, *George Soros: rocketing oil price is a bubble*, DAILY TELEGRAPH (May 27, 2008), available at <http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/05/26/cnsoros126.xml> (last visited June 21, 2008) (quoting Mr. George Soros as stating “Speculation . . . is increasingly affecting the price”); Written Testimony of Michael Masters, *Hearing Before the Committee on Homeland Security and Governmental Affairs, U.S. Senate 2* (May 20, 2008), available at http://hsgac.senate.gov/public_files/052008Masters.pdf (last visited June 21, 2008) (quoting Michael W. Masters as stating “Are Institutional Investors contributing to food and energy price inflation? And my unequivocal answer is YES”); Alejandro Lazo, *Energy Stocks Haven’t Caught Up With Oil Prices*, WASH. POST (Mar. 23, 2008), available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/03/21/AR2008032103825.html> (last visited June 21, 2008) (quoting Mr. Fadel Gheit as stating “The largest speculators are the largest financial companies”); MICHELLE FOSS, UNITED STATES NATURAL GAS PRICES TO 2015 34 (2007), available at <http://www.oxfordenergy.org/pdfs/NG18.pdf> (last visited June 21, 2008) (asserting “The role of speculation in oil markets has been widely debated but could add upwards of \$20 to the price per barrel”); Advantage Business Media, *Economist Blames Subsidies for Oil Price Hike*, CHEM.INFO (2008), available at <http://www.chem.info/ShowPR.aspx?PUBCODE=075&ACCT=0000100&ISSUE=0609&ORIGRELTTYPE=DM&RELTTYPE=PR&PRODCODE=00000&PRODLETT=M&CommonCount=0> (last visited June 21, 2008) (quoting Dr. Michelle Foss as stating “We have an overpriced commodity, and this is going to be around for a while”); Kenneth N. Gilpin, *OPEC Agrees to Increase Output in July to Ease Oil Prices*, N.Y. TIMES (June 3, 2004), available at <http://www.nytimes.com/2004/06/03/business/03CND-OIL.html?ex=1401681600&en=5dbd50c5b369795b&ei=5007&partner=USERLAND> (last visited June 21, 2008) (quoting Mr. Kyle Cooper as stating “There is not a crude shortage, which is why OPEC was so reluctant to raise production.”); Upstream, *Speculators ‘not to blame’ for oil prices*, UPSTREAMONLINE.COM, (April 4, 2008), available at <http://www.upstreamonline.com/live/article151805.ecce> (last visited June 21, 2008) (quoting Mr. Sean Cota as stating “It has become apparent that excessive speculation on energy trading facilities is the fuel that is driving this runaway train in crude prices”); Mike Norman, *The Danger of Speculation*, FOXNEWS.COM (Aug. 19, 2005), available at <http://www.foxnews.com/story/0,2933,166038,00.html> (last visited June 21, 2008) (Mr. Norman stating “Oil prices are high because of speculation, pure and simple. That’s not an assertion, that’s a fact. Yet rather than attack the speculation and rid ourselves of the problem, we flail away at the symptoms.”).

⁸ INTERNATIONAL MONETARY FUND, REGIONAL ECONOMIC OUTLOOK: MIDDLE EAST AND CENTRAL ASIA 27-28 (2008) (“Producers and many analysts say it is speculative activity that is pushing up oil prices now. Producers in particular argue that fundamentals would yield an oil price of about US \$80 a barrel, with the rest being the result of speculative activity.”); see also Neil King Jr., *Saudi Arabia’s Leverage In Oil Market Is Sapped*, WALL STREET J. (June 16, 2008), available at http://online.wsj.com/article/SB121355902769475555.html?mod=googlenews_wsj (last visited June 21, 2008) (quoting Saudi Oil Minister Ali Naimi as saying skyrocketing oil prices were “unjustified by the fundamentals” of supply and demand).

⁹ In a rare move representatives of the world’s largest oil producers and consumers have issued a joint working paper in advance of a joint summit on oil prices yesterday, which calls for worldwide regulation to “tackle issues” and to “improve the transparency and regulation of financial markets through measures to capture more data on index fund activity and to examine cross exchange inter-actions in the crude market.” Bernd Radowitz & Reem Shamseddine, *Oil Summit to Take on Speculators*, WALL ST. J. (June 21, 2008), available at <http://www.moneyweb.co.za/mw/view/mw/en/page94?oid=211868&sn=Detail> (last visited June 22, 2008).

¹⁰ See June 2007 Report, *supra* note 5, at 27.

¹¹ See *id.* at 42.

alia, @ 30% of trades in U.S. WTI futures.¹² The Dubai Mercantile Exchange, in affiliation with NYMEX, a U.S. exchange, has also been granted permission to begin trading the U.S. delivered WTI contract on U.S. terminals, but is, by virtue of a CFTC no-action letter, to be regulated by the Dubai Financial Service Authority (“DFSA”).¹³

NYMEX itself, the U.S. premier regulated energy futures contract market, is reported to be planning to have a London trading platform registered with the U.K.’s FSA,¹⁴ after which it would apply for the foreign board of trade no action relief that has already been granted to ICE and DME. Providing NYMEX’s London trading platform with this kind of no action relief would convert full U.S. regulation of the most important crude oil futures contracts to substantial U.K. oversight. These staff informal actions effectuating the exemptions for “foreign” owned U.S. trading terminals by their own terms make it clear that they may be instantly revoked by the CFTC.¹⁵

One final gap in the oversight of speculation in the U.S. crude oil and agricultural markets was dramatically illuminated in the testimony of Michael W. Masters, Managing Member of Masters Capital Management, LLC, before this Committee on May 20, 2008.¹⁶ Mr. Masters demonstrated that large financial institutions, such as investment banks, which were “hedging” their off exchange futures transactions on energy and agricultural prices on U.S. regulated exchanges, were being treated by NYMEX, for example, and the CFTC as “commercial interests,” rather than as the speculators.¹⁷ By lumping large financial institutions with traditional commercial oil dealers (or farmers),¹⁸ even fully regulated U.S. exchanges were not applying traditional and time tested speculation limits to the transactions engaged in by these institutions.¹⁹ Mr. Masters persuasively demonstrated that a significant percentage of the trades in WTI futures, for example, were controlled by what in common parlance and common sense would be considered non-commercial interests.²⁰ These exemptions from speculation limits for large financial institutions hedging off exchange

¹² See Written Testimony of Professor Michael Greenberger, *Energy Market Manipulation and Federal Enforcement Regimes: Hearing before the S. Comm. on Commerce, Science, and Transportation*, 3 (2008), available at http://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1026&context=cong_test (last visited June 21, 2008).

¹³ Dubai Mercantile Exchange Ltd., CFTC No-Action Letter, 2007 CFTC Ltr. LEXIS 6 (May 24, 2007).

¹⁴ Jeremy Grant, *Nymex's Long Road to the Electronic Age*, FINANCIAL TIMES (Feb. 17, 2006), at 39 (“Nymex has indicated that it might be forced to move its electronically traded WTI to London so that it can compete on a level playing field with ICE.”).

¹⁵ See Greenberger, *supra* note 1, at 11-12 (providing a complete discussion of the no-action letter process including termination).

¹⁶ Written Testimony of Michael Masters, *Hearing Before the Committee on Homeland Security and Governmental Affairs, U.S. Senate* (May 20, 2008), available at http://hsgac.senate.gov/public/_files/052008Masters.pdf (last visited June 21, 2008).

¹⁷ *Id.* at 7-8.

¹⁸ Gene Epstein, *Commodities: Who's Behind The Boom?*, BARRON'S 32 (March 31, 2008) (“The speculators, now so bullish, are mainly the index funds. . . . By using the [swaps dealers] as a conduit, the index funds get an exemption from position limits that are normally imposed on any other speculator, including the \$1 in every \$10 of index-fund money that does not go through the swaps dealers.”)

¹⁹ Masters, *supra* note 16, at 7.

²⁰ *Id.* at 8, 11. In testimony given by George Soros before the Senate Commerce Committee on June 3, 2008, he reached much the same conclusion as has Mr. Masters. Matthew Leising, *Soros Says Record Oil Prices Result of “Bubble,”* BLOOMBERG (June 3, 2008). He concluded there that commodity index investment is “not a legitimate asset class.” *Id.*

“swaps” transactions emanates from a CFTC letter issued on October 8, 1991²¹ and which have continued to be issued I am told as recently as last week.

Again, while the principal focus to date has been on skyrocketing energy prices, Mr. Masters’ testimony before this Committee, aided by a widely discussed cover story in the March 31, 2008 issue of *Barron’s*,²² have made clear that the categorization of swaps dealers outside of speculative controls even on U.S. regulated contract markets, has been a cause of great volatility in the farm belt, as well as the energy markets.

Virtually all parties now agree the Enron, London/Dubai, and Swaps Dealers Loopholes must be closed. On June 18, 2008, the Food Conservation and Energy Act of 2008²³ (the “Farm Bill”) was enacted into law by a Congressional override of President Bush’s veto. Title XIII of the Farm Bill is the CFTC Reauthorization Act of 2008, which, in turn, includes a language providing the CFTC with authority to require on a case-by-case basis that a now unregulated energy futures contract be brought within the regulatory requirements of a U.S. regulated contract market. To accomplish this result, the CFTC must that the contract “serve[s] a significant price discovery function.”²⁴

It has also been widely reported that the CFTC intends to use the new legislation to demonstrate that only a single unregulated natural gas futures contract, *and not any crude oil futures contracts*, should be removed from the Enron Loophole and become fully regulated. Thus, by the CFTC’s view of this legislation, crude oil, gasoline, and heating oil futures contracts will not be covered by the new legislation.

The CFTC has also made it clear that the Farm Bill amendment will not cover any U.S. delivered futures contracts traded on the U.S. terminals of foreign exchanges operating pursuant to CFTC staff no action letters. As mentioned above, the Intercontinental Exchange (“ICE”) of Atlanta, Georgia, for purposes of facilitating U.S. delivered WTI crude oil futures, has been deemed by the CFTC, through an informal staff no action letter, to be a U.K. entity not subject to direct CFTC regulation even though ICE maintains U.S. headquarters and trading infrastructure, facilitating, *inter alia*, @ 30% of trades in U.S. WTI futures. Moreover, the Dubai Mercantile Exchange (“DME”), in affiliation with NYMEX (a U.S. exchange) has also been granted permission to trade the U.S. delivered WTI contract on U.S. terminals, but is, by virtue of a CFTC no action letter, to be regulated by the Dubai Financial Service Authority (“DFSA”). Again, the CFTC will not rely on the plain language of the Farm Bill amendment to close the “London/Dubai” Loophole.

The “Swaps Dealer” Loophole was only brought to the attention of Congress through this Committee’s May 20, 2008 hearing and thus that problem was not addressed by the Farm Bill amendment.

²¹J. Aron & Co., CFTC Interpretive Letter, 1991 CFTC Ltr. LEXIS 18 (Oct. 8, 1991).

²² Gene Epstein, *Commodities: Who’s Behind The Boom?*, BARRON’S 32 (March 31, 2008) (“The speculators, now so bullish, are mainly the index funds. . . . By using the [swaps dealers] as a conduit, the index funds get an exemption from position limits that are normally imposed on any other speculator, including the \$1 in every \$10 of index-fund money that does not go through the swaps dealers.”).

²³ Food Conservation and Energy Act of 2008, Pub. L. No. 110-246, § 13201; 122 Stat. 1651 (2008).

²⁴ *Id.*

The Many Bills Now Pending Aimed at Closing the Enron, London/Dubai, and/or Swaps Dealers Loopholes

In the wake of the skyrocketing cost of, *inter alia*, gasoline and heating oil over the last few weeks, a great deal of legislation has been introduced to close each of the loopholes blamed for allowing speculation to go unpunished in the U.S. energy futures markets.

For example, Chairman Bart Stupak, of the House Energy and Commerce Subcommittee on Oversight and Investigations, introduced last Friday, June 21, 2008, legislation that requires, *inter alia*, all energy futures contracts executed in the U.S. to be traded on U.S. regulated contract markets, thereby fully reversing the Enron Loophole by returning all energy futures trading to where it was immediately prior to that provision's passage, i.e., on regulated exchanges;²⁵ expressly bars over the counter (i.e., trading outside of a regulated U.S. contract market) energy futures "swaps" involving transactions of futures energy contracts to be delivered in the U.S. or conducted using computer terminals in the U.S.;²⁶ and nullifies after a grace period all no actions letters previously granted to exchanges trading futures energy contracts to be delivered in the U.S. or using computer terminals in the U.S.²⁷

Senators Cantwell (D-WA) and Snowe (R-ME) have introduced legislation directed to the London/Dubai Loophole that would require all trading on U.S. platforms to be governed fully and directly by U.S. futures law.²⁸ Senator Nelson (D-FL) has introduced legislation that would close completely the Enron and Swaps Dealer Loophole by requiring all energy futures contracts to be traded on regulated exchanges.²⁹ Senators Durbin (D-IL) and Levin (D-MI), *inter alia*, have introduced legislation designed to close the London/Dubai Loophole by ratcheting up CFTC oversight of both the foreign regulator and foreign exchange trading energy futures on U.S. terminals.³⁰

Congressman Van Hollen (D-MD) and Congresswoman DeLauro (D-CT) last week introduced legislation that mirrors in result Chairman Stupak's bill to close the Enron, London/Dubai, and Swaps Dealer Loopholes.³¹

²⁵ PUMP Act (2008), H.R., 110th Cong. § 2(a), available at <http://www.house.gov/stupak/pumpbill.pdf>.

²⁶ *Id.* at § 2(b).

²⁷ *Id.* at § 2(e)(2).

²⁸ Policing United States Oil Commodities Markets Act of 2008, S. 3122, 110th Cong. (2008), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:s3122is.txt.pdf (last visited June 21, 2008).

²⁹ S. 3134, 110th Cong. (2008), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:s3134is.txt.pdf (last visited June 21, 2008).

³⁰ Increasing Transparency and Accountability in Oil Prices Act of 2008, S. 3130, 110th Cong. (2008), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:s3130is.txt.pdf (last visited June 21, 2008).

³¹ Energy Markets Anti-Manipulation and Integrity Restoration Act, H.R., 110th Cong. (2008).

Senators Lieberman's and Collin's Proposed Options to Control Speculation Energy Futures Markets

Chairman Lieberman and Ranking Member Collins have approached closing these loopholes for speculators through somewhat different devices than discussed above, but, most importantly, their proposals focus on dysfunctions caused by speculation in both the energy *and* agricultural futures markets.

On June 18, 2008, Senators Lieberman and Collins introduced three proposals for discussion purposes designed to drain excessive speculation from the energy and agricultural markets.

The first proposal for discussion would require the CFTC to promulgate tight speculation limits on futures traders, who are not bona fide commercial hedgers involved with managing risk relating to businesses engaged in buying or selling the underlying physical agricultural or energy commodity.

One of the foremost tools used to ensure that futures markets are controlled by economic fundamentals has been the establishment of maximum position limits on non-commercial futures traders in order to prevent “excessive speculation . . . causing sudden or unreasonable fluctuations or unwarranted changes in the price” of a commodity.³²

Bona fide commercial hedgers are generally exempted from these limits.³³ The CFTC has used this power to directly set such limits on the trading of certain agricultural commodities, but has otherwise delegated to its regulated contract markets the establishment of these limits.³⁴ These limits are not aggregated across contract markets, i.e., a non-commercial trader may have different limits separately imposed by each contract market in which he or she is trading without those markets knowing the full extent of the trader's speculation across all markets.

Moreover, to the extent energy futures may be traded off exchange by virtue of the Enron Loophole, that trading is almost always unencumbered by such limits. Because agricultural futures were not deregulated,³⁵ they must be traded on an CFTC sanctioned exchange and therefore are subject to these limits. However, to my mind inexplicably, the agricultural index funds are traded off exchange as Mr. Masters' testimony and the business media have made clear. That would seem to be in contravention of existing law. While there is a general swaps exemption within the statute that might arguably free these swaps from regulation, that exemption is by its terms only applicable to financial swaps³⁶ –not to agricultural index funds traded off exchange. Finally, many FBOTs with U.S. trading terminal rights in the U.S. similarly do not impose speculation limits either within the U.S. or in their home country.³⁷

³² 7 U.S.C. § 6a(a).

³³ 17 C.F.R. § 150.5.

³⁴ PHILIP MCBRIDE JOHNSON & THOMAS LEE HAZEN, DERIVATIVES REGULATION 41718 (2004 ed.).

³⁵ See *supra* page 7.

³⁶ 7 U.S.C. § 2(g).

³⁷ See FSA Handbook, Rec. § 2.6.1-2, available at <http://fsahandbook.info/FSA/html/handbook/REC/4/2D> (last visited June 22, 2008); Jeremy Grant, *CFTC in talks to plug 'London loophole,'* FINANCIAL TIMES (June 10, 2008), available at <http://www.ft.com/cms/s/0/b962d938-3716-11dd-bc1c-0000779fd2ac.html> (last visited June 22, 2008).

Because the Lieberman/Collins speculation limits option as applied to U.S. traders would be aggregated across all exchanges, i.e., U.S. regulated, over-the-counter or foreign, the proposal should have a considerable ameliorating effect in dampening excessive speculation in both the unregulated energy and agricultural futures markets, especially with regard to off exchange energy and index funds.

My own view is that either in isolation or joined with other pending legislation eliminating the swaps exemption for energy futures contracts,³⁸ the first Lieberman/Collins option would have a significant on controlling excessive speculation in the energy and food sectors, thereby lowering the cost of gasoline and food for the American consumer.³⁹

The second Lieberman/Collins legislative option would require the CFTC develop speculation limits on each contract traded, rather than by application to individual traders. In other words, as I understand it, there would be limits established by either the CFTC or the U.S. regulated contract markets on the “share” of a contract eligible to speculators. While the second proposed option would likely have much the same effect as the first, I am concerned that it would encourage a “race” to the exchange allowing large institutional investors with sophisticated trading terminals to crowd out smaller investors not able to move as quickly to take part in that share of a contract limited to speculation.

The third option introduced for discussion would place absolute restrictions on public and private pension funds with assets of more than \$500 million from participating in the commodity markets in general, including regulated, over-the-counter or foreign markets; place a similar financial ceiling on U.S. or foreign governmental entities (such as public university endowments or sovereign wealth funds) from participating in agricultural or energy markets unless there was a bona fide commercial need to do so; and, finally, the \$500 million asset ceiling would be applied to all institutional investors with regard to what are commonly referred to as the agricultural and energy index funds.

Again, the soaring inflationary impact of speculation in the agricultural and energy markets clearly demands strong measures. Moreover, inasmuch as the informed wisdom of respected experts is that soaring food and energy prices reflect a bubble that will at some point burst, there is a legitimate concern about limiting the participation of pension funds and endowments in these markets. As was true in the complex investment vehicles associated with the housing bubble, today’s nice profits may well be tomorrow’s crippling losses. Finally, the “ceilings” imposed in option three would be much easier to administer than developing aggregated speculation limits by investor (as in option one) or by market (as in option two).

³⁸ As mentioned above, it is my judgment at this time that any off exchange agricultural swaps are in violation of the CFMA. Because of the seeming substantial adverse impact on inflationary pressure in the agricultural sector, those indices may very well be challenged by the private right of action or *parens patriae* provisions within the Commodity Exchange Act. The existing bar to off exchange agricultural swaps may also very well be the reason no legislator has yet introduced a bill to bar agricultural swaps. Whatever the lawfulness of off exchange agricultural index funds, the first Lieberman/Collins option would have an ameliorating effect draining excessive speculation from those investments.

³⁹ Chairman Stupak also includes within his recently introduced legislation the aggregation of speculation limits across all futures markets and eliminating speculation limit exemptions for swaps dealers on U.S. regulated contract markets. PUMP Act (2008) at § 2.

That being said, I worry about the possible unintended consequences of hard across the board limits on investment strategies of those institutions exceeding the proposal's ceiling or bar. In this regard, I view the first option proposed to be so appealing and effective, i.e., aggregated speculation limits on U.S. traders applicable to regulated, over-the-counter, and foreign markets, that my judgment is that the hard and fast ceilings should be not be viewed as preferably as the proposal in option one.

Other Considerations

I would also recommend that this Committee seriously consider proposals beyond speculative controls that have been proposed to otherwise all agricultural and energy futures executed within the U.S. into a fully transparent regulatory system. I say this, because while speculation limits will be therapeutic, there are other substantial abuses in unpoliced markets that have been recognized as unhinging those markets from economic fundamentals, including fraud and manipulation engaged in by those who may be well within the applicable speculation limits.

In this latter regard, one only needs to look at the emergency and self-regulatory tools afforded the CFTC and its regulated contract markets to see the way in which these markets are monitored for malpractices beyond concerns about excessive speculation.

Those additional tools include large trader reporting that informs the CFTC and its markets about the real party in interest in trading and whether those parties are engaged in “front running or trading ahead of a customer; wash or accommodation trading (transactions creating the appearance of trading activity, but which have no real economic effect); prohibited cross trading (trading directly or indirectly with a customer except under very limited circumstances, or matching two customer orders without offering them competitively); prearranged trading; and non-competitive trading.”⁴⁰

Described as the CEA's “most potent tool,” section 8a (9) provides that “whenever [the CFTC] has *reason to believe* that an emergency exists,” it may take such actions “including, but not limited to “the setting of temporary emergency margin levels on any futures contract [and] the fixing of limits that may apply to a market position.”⁴¹ An “emergency” is defined:

to mean, in addition to threatened or actual market manipulations and corners, any act the United States or a foreign government affecting a commodity or any other major market disturbance *which prevents the market from accurately reflecting the forces of supply demand for such commodity.*⁴²

Finally, the “core principles” within the CEA that are applicable to approved U.S. regulated contract markets emphasize the importance of having those markets regulated through aggressive surveillance practices which serve as the first line of defense for the CFTC in detecting fraud, manipulation, excessive speculation, and other unlawful trading malpractices.⁴³

⁴⁰ 7 U.S.C. §§ 12(a) & (c) (2008).

⁴¹ 7 U.S.C. § 12a(9) (2008) (emphasis added).

⁴² *Id.* (emphasis added).

⁴³ 7 U.S.C. § 7(d)(2)-(6) (2008); (2) (compliance with rules); (3) (contracts not readily subject to manipulation); (4) (monitoring of trading); (5) (position limits); (6) (emergency authority); 7 U.S.C. § 7a(d)(2)-(3) (2008); (2) (compliance with rules); (3) (monitoring of trading).

Without aggressive self-policing of the entirety of the regulated U.S. futures markets, the CFTC simply cannot do its job.

Again, neither the over-the-counter market nor the foreign exchanges with terminals in the U.S. which are regulated by their home country have as a general matter effective large trader reporting, emergency intervention powers, or self-regulation. Since each of these tools is time tested measure to ensure that these markets are “*accurately reflecting the forces of supply demand for [a] commodity,*” serious consideration should be joining with this Committee’s proposed speculation controls.

With regard to U.S. futures trading executed in the United States, especially insofar as that trading so dramatically impacts prices consumers pay for their everyday needs, the American public deserves the application of these time tested regulatory protections in these critically important U.S. markets.

Finally, I want to congratulate this Committee for providing a continuing and highly influential forum for a serious and thorough discussion of these issues and for the thoughtfulness of the options it has introduced for debate. The impact of the futures markets has been little understood by the American public, possibly seeming as arcane as the workings of the stock markets were to Americans in the 1920’s. The economic hardship the country is presently experiencing from soaring food and energy prices, as well as the credit crunch, demand a more thorough understanding of these often opaque financial institutions. Educating the public is the best weapon we have to avoid the need to make same kind of analogies to the 1930’s, as I now make to the decade that preceded it.+