

Guaranteeing Our Dodd-Frank Victories
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Excessive Speculation in Oil and Agricultural Commodities

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Levin-Coburn Report on Excessive Speculation in the Wheat Market

- On June 24, 2009, the Senate Investigations Subcommittee released the Levin-Coburn Report on Excessive Speculation in the Wheat Market.¹ The report demonstrated that:
 - “[o]ver the past four years . . . increases in wheat prices were nearly as steep as the increases in the price of oil,” during which period wheat prices rose “to record heights;”²
 - there is “significant and persuasive evidence that the large number of wheat futures contracts (long open interest) held by commodity index traders is a primary reason for the pricing problems in the wheat market . . . including . . . the disconnect between wheat futures prices and cash market fundamentals . . . during 2008;”³
 - “commodity index instruments were, in essence, *speculative bets*”⁴ and “the activities of [the] commodity index traders, in the aggregate, constituted ‘excessive speculation’ in the wheat market;”⁵ and
 - “[t]he total value of the *speculative* investments in commodity indexes has increased an estimated tenfold in five years, from an estimated \$15 billion in 2003, to around \$200 billion by mid-2008.”⁶

Speculation in the Oil Market

- Increasing Prices and Market Volatility
 - Chilton: in 2008, the price of a barrel of oil fluctuated between \$60 and \$150 per barrel (while supply and demand remained fairly constant), and the price of a gallon of gas rose to \$4.10 per gallon (the highest price per gallon ever); we are starting to see the same thing again now – gas prices are now at \$3.76 and are approaching the 2008 peak.⁷

¹ Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, *Excessive Speculation in the Wheat Market* (June 24, 2009), available at <http://www.levin.senate.gov/imo/media/doc/supporting/2009/PSI.WheatSpeculation.062409.pdf>.

² *Id.* at 37.

³ *Id.* at 120.

⁴ *Id.* at 94 (emphasis added).

⁵ *Id.* at 2.

⁶ *Id.* at 5 (emphasis added).

⁷ CFTC Commissioner Bart Chilton, *The Cost of Energy Speculation*, CNBC (March 8, 2012), available at <http://news.yahoo.com/video/business-15749628/the-cost-of-energy-speculation->

- 2011: oil prices climbed to over \$110 per barrel in May, and fell to \$77 per barrel in early October; a drop of more than 30% over four months.⁸
- Three years ago: the average price for a gallon of gasoline was \$1.94; now it is more than \$3.80 per gallon; U.S. demand for oil is at its lowest level since April 1997.⁹
- Speculation is the Culprit
 - ExxonMobil CEO Rex Tillerson: speculation is contributing to oil prices; he estimated the price of a barrel would be between \$60 and \$70, instead of \$110, if the price was governed exclusively by supply and demand.¹⁰
 - Chris Cook, former compliance and market supervision director of the International Petroleum Exchange: “oil market price has been inflated twice by passive (inflation hedgers) investors . . . once from 2005 to June 2008; and again from early 2009 to date.”¹¹
 - Prices are unhinged from market fundamentals—they continue to rise despite a reduction in demand:
 - “U.S. demand for oil and refined products — including gasoline — is down sharply from last year, so much that the United States has become a net exporter of gasoline.”¹²
 - Chris Cook, former compliance and market supervision director of the International Petroleum Exchange: “demand in the West is dropping like a

28550141.html#crsl=%252Fvideo%252Fbusiness-15749628%252Fthe-cost-of-energy-speculation-28550141.html (Commissioner Chilton’s discussion of the similarities between 2008 and the present runs from 5:05-6:00).

⁸ Senator Carl Levin Opening Statement, Hearing of the Permanent Subcommittee on Investigations, *Excessive Speculation and Compliance with the Dodd-Frank Act*, 4 (Nov. 3, 2011), available at http://www.google.com/url?sa=t&rct=j&q=senator%20carl%20levin%20opening%20statement%20of%20the%20permanent%20subcommittee%20on%20investigations%20excessive%20speculation%20and%20compliance%20with%20the%20dodd-frank%20act%20&source=web&cd=2&ved=0CCcQFjAB&url=http%3A%2F%2Fwww.hsgac.senate.gov%2Fdownload%2Flevin-hearing-statement-110311&ei=G4psT56RHILf0QGK2d3TBg&usg=AFQjCNHSBAGuw2TzHb7n-9OKFCa_jKECXw [hereinafter Senator Carl Levin Opening Statement].

⁹ Press Release, Office of U.S. Senator Bernie Sanders, *Senate Bill Would Force Emergency Action to Cut Gas Prices* (March 21, 2012), available at <http://www.sanders.senate.gov/newsroom/news/?id=4a886791-28ac-46fb-8a90-07185484a360> (The bill is sponsored by Sanders, and cosponsored by Blumenthal, Brown, Cardin, Franken, Klobuchar, and Nelson) [hereinafter Press Release].

¹⁰ Senator Carl Levin Opening Statement, *supra* note 8, at 4.

¹¹ Chris Cook, *The Ghost of Enron Past Explains Oil Market Manipulation*, NAKED CAPITALISM (March 5, 2012), available at <http://www.nakedcapitalism.com/2012/03/chris-cook-the-ghost-of-enron-past-explains-oil-market-manipulation.html>.

¹² Kevin G. Hall, *Speculators Blamed for Rising Oil, Gas Prices*, MCCLATCHY NEWSPAPERS (Feb. 23, 2012), available at <http://seattletimes.nwsourc.com/text/2017563277.html>.

- stone”¹³
- The Energy Information Administration reported that as of the week ending February 10, 2012:¹⁴
 - Total products supplied over the last four-week period were down by 4.6 percent from the same time last year.
 - Motor gasoline product supplied over the last four weeks was down by 6.4 percent from the same time last year.
 - “Inventories of stored oil...are unusually high.”
 - “According to the International Energy Agency, in the last quarter of 2011 the world oil supply rose by 1.3 million barrels per day while demand only increased by 0.7 million barrels per day. Yet, during this same period, the price of Texas light sweet crude rose by over 12%.”¹⁵
 - Another example of an unhinged market:¹⁶
 - Four months ago: light, sweet crude traded at \$79.20 a barrel.
 - Now: light, sweet crude trades at over \$105 a barrel.
 - February 23: prices increased on news that Iran would halt oil shipments to Britain and France.
 - BUT: Britain and France had already stopped buying Iranian oil (+ alternative supplies easily can make up for any loss of Iranian imports).
 - The Iranian security premium should be, at most, \$10 a barrel, so oil prices should be no more that \$95 a barrel.
 - Speculators radically outnumber commercial end-users:
 - Gensler: oil speculators control over 80 percent of the energy futures market—this figure has more than doubled over the past decade.¹⁷
 - CFTC on February 14, 2012: 36 percent of the oil market is commercial and 64 percent is speculative.¹⁸
 - Commodity index funds:
 - Air Line Pilots Association: in the past decade speculation in commodities has doubled, and the cost of a barrel of oil has ranged between \$31 and \$145.¹⁹
 - Federal Reserve Bank of St. Louis: “Speculation was the second-largest contributor to oil prices and accounted for about 15 percent of the rise. The effect that speculation had on oil prices over this period coincides

¹³ Cook, *supra* note 11.

¹⁴ Hall, *supra* note 12.

¹⁵ Letter to Chairman Gensler, and Commissioners Chilton, Wetjen, Sommers, and O’Malia by Senator Bernie Sanders et al. (March 4, 2012), *available at* <http://www.sanders.senate.gov/imo/media/doc/CFTCPositionLimitsLetter.pdf> [hereinafter Senator Sanders Letter]. *See also* Press Release, *supra* note 9.

¹⁶ Hall, *supra* note 12.

¹⁷ Senator Sanders Letter, *supra* note 15.

¹⁸ Hall, *supra* note 12.

¹⁹ Pilot Partisan, *Wall Street Flies High on Increased Oil Prices* (March 13, 2012), *available at* <http://pilotpartisan.com/category/fuel-prices/>.

closely with the dramatic rise in commodity index trading—resulting in concerns voiced by policymakers.”²⁰

- Chilton: the ratio of long to short positions held by passive investors in the oil market is 12:1—this ratio is the highest it has ever been and is the result of continued investment in commodities by “massive passives” (i.e. pension funds and other forms of managed money).²¹
- Forbes: as of February 23, 2012, speculators “held positions in NYMEX crude oil contracts equivalent to 233.9 million barrels of oil— the equivalent of about one year’s crude oil supply from Iran” to countries like France, Italy, and Spain.²²
- Immediate cost of speculation:
 - Chilton: speculation costs the airline industry \$9.8 billion per year and the trucking industry more than \$29 billion a year.²³
 - Mark Larson, Executive Director of the Colorado Wyoming Petroleum Marketers and Convenience Store Association: consumers are paying a 30% speculator tax when they fill up at the pump.²⁴
 - Forbes: absent excessive speculation a barrel of oil would cost \$74.61, not the \$105-110 a barrel it costs today.²⁵
 - Forbes (using Goldman Sachs figures): speculation adds as much as \$0.56 to the price of a gallon of gas.²⁶
 - Heating oil: purchasing futures and options added 2 to 6 cents to each gallon 7-8 years ago; now it adds 37 cents a gallon to hedge.²⁷
- Long-term costs of speculation
 - Brookings: radical fluctuations in the price of oil slow GDP growth significantly.²⁸

²⁰ Luciana Juvenal & Ivan Petrella, Federal Reserve Bank of St. Louis, Economic Research, *Speculation in the Oil Market* (March 12, 2012), available at http://research.stlouisfed.org/publications/es/article/9179?utm_source=Twitter&utm_medium=S&utm_campaign=Twitter.

²¹ Chilton, *supra* note 7, at 4:124:42.

²² Robert Lenzer, *Speculation In Crude Oil Adds \$23.39 To The Price Per Barrel*, Forbes (Feb. 27, 2012), available at <http://www.forbes.com/sites/robertlenzner/2012/02/27/speculation-in-crude-oil-adds-23-39-to-the-price-per-barrel/>.

²³ Chilton, *supra* note 7, at 0:26-0:40.

²⁴ Hendrik Sybrandy, *Gas Prices Continue to Rise*, FOX 31 DENVER (March 13, 2012), available at <http://kdvr.com/2012/03/13/gas-prices-continue-to-rise/>.

²⁵ Lenzer, *supra* note 22.

²⁶ *Id.*

²⁷ Graham Bowley & William Neuman, *Companies Hedge Bets at a Cost to Consumers*, N.Y. TIMES (May 5, 2011), available at http://www.nytimes.com/2011/05/06/business/economy/06commodities.html?_r=2&ref=graham-bowley.

²⁸ Isabel V. Sawhill, *How Higher Gas Prices Hurt Less Affluent Consumers and the Economy*, BROOKINGS (March 22, 2012), available at http://www.brookings.edu/opinions/2012/0306_gas_prices_sawhill.aspx.

- Goldman Sachs: “the oil price increase since December will shave between a quarter and a half of a percentage point off of real GDP growth over the next year, and the effects could be more dire if oil prices continue to rise.”²⁹

Speculation in Agricultural Commodities

- French President Nicholas Sarkozy has made rising food prices a priority for the G-20 and plans to limit the influence of speculative investors in legislation that he plans to forward to finance ministers in July 2012.³⁰
- Increase in Pricing
 - Food prices hit record highs in the early part of 2011.³¹
 - Last fall Starbucks raised the price of some drinks; this spring it increased the price of its bagged coffees by an average of 12 percent.³²
- Market Volatility
 - November 2011: sugar futures fell more than 20 percent in two days (and sugar futures often swing more in one day than they used to move in a month).³³
 - March 2012: cocoa futures plummeted 12 percent in less than a minute and then quickly recovered in a “flash crash.”³⁴
 - March 2012: prices for a wide range of commodities plunged—the CRB (Commodities Research Bureau) commodities index plunged 4.9 percent.³⁵
 - “Cotton futures have fluctuated so wildly that they flipped market circuit-breakers on about two-thirds of the trading days this year.”³⁶
 - Market volatility is forcing major end-users to leave the market:
 - JBS, America’s largest meat producer, has looked for alternatives to the futures market to hedge its pricing:³⁷
 - “But as futures have become less predictable, the company has tried to find other ways to manage its risk. It now often signs longer-term supply contracts with the cattle and hog producers it buys from and the supermarket chains it sells to, with provisions aimed at sharing the risk of rising costs.”
 - Plains Cotton Cooperative Association, one of the biggest cotton producers in the United States, has also cut its hedging activity³⁸
 - Wallace L. Darneille: “The market is broken,” he said. “It no

²⁹ *Id.*

³⁰ Dow Jones Newswires, *Deutsche Bank Rules Out New Food Investment Products This Year*, FOX BUSINESS NEWS (March 20, 2012), available at <http://www.foxbusiness.com/news/2012/03/20/deutsche-bank-rules-out-new-food-investment-products-this-year/#ixzz1p1OA1m99> [hereinafter Fox Business News].

³¹ *Id.*

³² Bowley, *supra* note 27.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

longer serves its purpose.”

- ICE Futures U.S. (trades futures contracts for cotton, cocoa, coffee, sugar, and orange juice): sellers of commodities have complained about price swings in commodity futures markets.³⁹
- Speculation in Agricultural Commodities Aligns with Speculation in Oil Markets
 - In 1991 the CFTC prevented commodity index funds from holding more than 5,000 wheat-futures contracts; the CFTC exempted several commodity index funds from this limit so that by 2001 commodity index funds held 130,000 wheat-futures contracts.⁴⁰
 - Speculators make up more than 70% of most commodities (not just oil) markets; producers and users now hold between 20 or 30% of the outstanding contracts in some markets.⁴¹
 - Commodity index investors and swap dealers spent about \$300 billion, mostly on long futures and swap contracts.⁴²
 - Exchange Traded Products have poured over \$120 billion of speculative money into U.S. commodity markets.⁴³
 - Over 40 commodity-related mutual funds have assets of over \$50 billion.⁴⁴
 - Goldman Sachs’s Goldman Sachs Commodity Index (GSCI) fund:
 - June 30, 2011: the fund held more than \$1.5 billion in assets and invested in 24 different commodities.
 - End of 2010: energy commodities comprised 2/3s of the fund; agricultural commodities comprised 22.6%; metals comprised 11.4%.
 - January 30, 2011: 49,120 entities owned shares of GSCI—up from 135 two years prior.⁴⁵
 - March 20, 2012: Deutsche Bank announced it would not create any new investment products in staple agricultural commodities this year; it is studying whether such products contribute to rising and increasingly volatile food prices.⁴⁶
 - “We recognize that the proper functioning of agricultural markets have wide social ramifications. Therefore we intend to proceed with caution and we will refrain from launching new staples-based public exchange-traded products this year[.]”⁴⁷

³⁹ *Id.*

⁴⁰ Frederick Kaufman, *The Food Bubble: How Wall Street Starved Millions and Got Away With It*, HARPER’S MAGAZINE, 31 (July 2010), available at <http://frederickkaufman.typepad.com/files/the-food-bubble-pdf.pdf>.

⁴¹ Senator Carl Levin Opening Statement, *supra* note 8, at 4.

⁴² *Id.*, at 2.

⁴³ *Id.*, at 3.

⁴⁴ *Id.*

⁴⁵ Tyson T. Slocum, Statement Before the Permanent Subcommittee on Investigations, *Excessive Speculation and Compliance with the Dodd-Frank Act*, 5 (Nov. 3, 2011), available at <http://www.hsgac.senate.gov/subcommittees/investigations/hearings/excessive-speculation-and-compliance-with-the-dodd-frank-act>.

⁴⁶ Fox Business News, *supra* note 30.

⁴⁷ *Id.*

- Deutsche Bank is retaining its four exchange-traded products.⁴⁸
- The Increase in High Frequency Trading Suggests an Increase in Speculators
 - “[H]igh-frequency trading now makes up 10 to 20 percent of the futures trading in many agricultural commodities, nearly a quarter of the trading in metals and 30 percent in energy futures markets.”⁴⁹

Effects of Speculation

- Oil speculation is driving up the cost of food:
 - March 20, 2012: indigenous peoples in Alaska are struggling with higher food prices: “We need the foods from our lands and waters to feed our families,” said Point Hope resident Rosemary Ahtuanguak. “We cannot afford to buy the foods that come up to the Arctic. The costs of transportation increase these costs, so that it can take your whole paycheck to try to feed your family from the store.”⁵⁰
- The 2008 food bubble resulted in a 250 million increase—in one year—in the ranks of the hungry.⁵¹
- Worldwide price of food rose by 80% between 2005 and 2008.⁵²
 - 49 million Americans found that they could not put a full meal on the table; demand for food stamps reached an all time high; and one in five children depended on food kitchens.⁵³
 - John Hummel of AIS Capital Management has predicted that commodity prices could advance another 460 percent above mid-2008 price peaks.⁵⁴

⁴⁸ *Id.*

⁴⁹ Bowley, *supra* note 27.

⁵⁰ Richard Harris, *Native Alaskans Divided On States Oil Drilling Debate*, NPR (March 20, 2012), available at <http://www.npr.org/2012/03/20/148754357/native-alaskans-divided-on-states-oil-drilling-debate>.

⁵¹ Kaufman, *supra* note 40, at 28.

⁵² *Id.* at 34.

⁵³ *Id.*

⁵⁴ *Id.*