

Testimony of Jeff Billings, Manager of Risk Management, Municipal Gas Authority of Georgia, on Behalf of the American Public Gas Association.

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Testimony of Jeff Billings, Manager of Risk Assessment for the Municipal Gas Authority of Georgia, on behalf of the American Public Gas Association to the Commodity Futures Trading Commission Hearing on Foreign Boards of Trade

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Chairman Jeffery and Members of the Commission, I am Jeff Billings, the Manager of Risk Management for the Municipal Gas Authority of Georgia, which is the largest non-profit natural gas joint action agency in the United States, serving 78 Members in Georgia, Alabama, Florida, Pennsylvania, Indiana and Tennessee. Those members in turn meet the gas needs of approximately 235,000 customers. The Gas Authority was formed in 1987 by an Act of the Georgia General Assembly to assist Municipal Members who own and operate natural gas distribution systems. I am testifying today on behalf of the American Public Gas Association ("APGA"), which is the national association of approximately 650 municipally and publicly-owned local distribution systems in 36 states. Publicly-owned gas systems are not-for-profit retail distribution entities that are owned by, and accountable to, the citizens they serve. They include municipal gas distribution systems, public utility districts, county districts, and other public agencies that have natural gas distribution facilities. All of the Members of the Gas Authority of Georgia are members of APGA. APGA and I very much appreciate the opportunity that the Commission has given us to testify today on the important issues that the Commission is

facing in evaluating how to treat nominally foreign exchanges that potentially have an important presence in and impact on the United States.

We believe that it is critically important for the Commission to approach these issues with certain basic principles in mind. I hope that you will agree that those principles should be rooted in the fundamentals premised that underlie the regulation of the futures markets in the United States. As the Commission itself recognized in the Request for Comment it issued in conjunction with this hearing,

“One of the primary purposes of regulating futures contracts is to ensure fair and orderly markets for U.S. producers and other commercial participants who use such contracts for price basing or hedging.”

The “Findings” codified in Section 3 of the Commodity Exchange Act (7 U.S.C. §5) similarly reflect this central purpose of protecting the price discovery and pricing information function of the futures markets:

“(a) Findings

The transactions subject to this chapter are entered into regularly in interstate and international commerce and are affected with a national public interest by providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.”

Commissioner Brown-Hruska aptly reiterated the importance of this price discovery function and the CFTC’s central role in protecting its integrity in a speech to the University of Houston Global Energy Management Institute this past January:

“Price discovery, which I have referred to as the life-blood of the free market system, occurs as the reactions of suppliers and

demanders of the resource are continually impounded into market prices.

“As a regulator of the futures markets, it is the CFTC’s role to protect that price discovery function -- to make sure that the markets are fair and not subject to manipulation.”

This fundamental purpose of CFTC oversight of futures markets is absolutely critical to the members of APGA and the millions of consumers that our members serve. The pricing of the natural gas we purchase and distribute to the public is inextricably tied to the price discovery function of the U.S. futures markets. Indeed, increasingly, physical gas is priced directly off of the exchange-traded contracts. As physical prices continue to be a derivative of the exchange price, it becomes increasingly important to ensure adequate price discovery. If the exchange markets are not transparent and efficient, then consumers all over the US will not be paying a fair price for the natural gas they consume. If those markets are susceptible to manipulation, then the price that consumers pay for the fuel needed to heat their homes and cook their meals will be susceptible to manipulation. It is that simple.

The pricing of natural gas is, of course, of critical importance to the nation. According to the Energy Information Administration, 4.8 trillion cubic feet (Tcf) of natural gas was delivered to residential consumers during 2005. Another 3.0 Tcf was delivered to commercial customers and 6.6 Tcf to industrial customers. Additionally 5.8 Tcf of natural gas was consumed for electric power, which also indirectly affects American consumers. With total annual US consumption of 20+ Tcf, every \$1/mcf swing in natural gas prices affects the US economy by \$20 billion.

Over the past few years, the critical importance of the CFTC's exercise of authority with regard to the natural gas market has been demonstrated quite dramatically by the series of enforcement actions taken by the Commission to address misconduct in the trading of natural gas. The Commission's investigations and enforcement actions not only have resulted in civil monetary payments of nearly \$300 million, and overall government settlements of over \$2 billion, but also the Commission's actions have brought to light widespread misconduct with respect to price reporting, wash trading and other practices that, in many instances, were designed to and had the potential for causing major price distortions in the natural gas marketplace. Without the ability of the CFTC to pursue these investigations and impose the significant sanctions it has meted out, it is probable that these activities would have continued to this day, and perhaps become even more widespread and pernicious.

For many decades, this Commission and its predecessor overseers of the futures markets in the United States have carefully formulated and enforced a series of requirements designed to ensure that the markets remain a fair and efficient mechanism for price discovery. Whether statutory prohibitions of non-competitive trading, such as wash trades, or regulatory requirements for large trader reports and position limits, the CFTC's structure for oversight of the futures markets has resulted in the most reliable and relied upon mechanisms for price discovery throughout the world. Nowhere is that function more successful or more important than in the energy markets in general and the natural gas market in particular.

Indeed, this critical role that the CFTC regulatory structure has played in ensuring that the markets remain fair and honest for end users has led APGA to press Congress to expand the

CFTC's authority to include within the large traders report information on the OTC derivative markets as well as the established exchanges. Natural gas contracts are susceptible to manipulation because the deliverable supply of natural gas is often small relative to the size of the cash and derivatives positions held by large traders. Therefore, it is important that the government be able to monitor large positions, in order to detect and prevent any squeezes or manipulations. Without comprehensive large trader position reporting, the government is currently handicapped in its ability to perform its critical role of detecting and deterring market misconduct, whether it be market congestion, wash trading, or false reporting, to name just a few.

As the Commission itself has recently stated, the large trader reporting system is at the heart of its market surveillance program. By enhancing the CFTC's surveillance tools in the natural gas market, an expansion of the CFTC's ability to obtain information concerning large positions held by traders in the OTC natural gas derivatives markets will allow the CFTC to better detect and prevent market manipulation and will help restore confidence in these vital national markets.

Applying these same principles that underlie the CFTC's regulatory mandate and which are so critical to the health and welfare of the natural gas market in the United States to the issues now before the Commission we believe will lead to certain compelling conclusions. The Commission simply cannot allow its important mission of protecting critical U.S. markets, such as the energy markets, to be circumvented simply by the device of placing computer servers offshore, or choosing to name non-US residents as officers or directors of a company. Neither of

those characteristics impact in the slightest the elements of trading that make futures trading of regulatory interest to the United States – namely, the impact of futures trading on price discovery in products that are, to use again the Commission’s words from the recent Request for Comment, “integral to the U.S. economy.”

For such products, we believe it is absolutely essential that (1) the full range of statutory and regulatory requirements that serve to ensure fair and efficient price discovery apply to the trading of contracts on such underlying products when (2) the characteristics of the contract and the trading of the contract indicate that it is likely to have a material impact on the price discovery for that product in the U.S. market.

Let me focus on the two essential elements of this standard that we urge the Commission to apply. First, once a product is found to have the essential characteristics that will cause it to impact materially on price discovery in the United States, we believe the *full* range of CFTC statutory and regulatory requirements that are designed to ensure fair and efficient pricing must apply. It may well be that there are certain other regulatory requirements, such as financial requirements for market participants, that can be considered in a different light. But we see no reason why any market which is likely to have a material impact on the price discovery of vital products in the U.S. should not be required to meet all of the statutory and regulatory requirements that have been carefully worked out over the decades to ensure that the pricing is fair and efficient. It may also be that the Commission can coordinate with foreign regulators who also have an interest in the same trading platforms, to ensure that reporting and other requirements are coordinated in a manner designed to avoid unnecessary duplication of effort or

expense on the part of market participants and the exchanges themselves. But such coordination should not become a guise for limiting the actual requirements to be applied and met. If the requirements that the statute and regulations impose are important to protecting the pricing of US products, then they are equally important wherever trading may take place that could adversely impact on that pricing.

Second, the application of the statutory and regulatory requirements should be triggered when the characteristics of the contract and the trading of the contract indicate that the trading on the platform in question is likely to have a material impact on the price discovery of an underlying product in the U.S. market. The product being impacted may be either the actual product underlying the contract *or* a related product that has a close pricing relationship to the actual product underlying the contract.

We do not take a position on exactly what combination of characteristics should trigger the application of U.S. statutory and regulatory requirements. That is, quite frankly, beyond our expertise. We ask only that the Commission embrace the standard I have set out as the guidepost by which the experts within the agency are to apply in evaluating when the trigger point is hit. The ultimate test may be affected by the characteristics of the contract, including form and location of delivery. It may be affected by who is trading in the market, from where the volumes originate, the nature of the dissemination of price information from the market, the uses of the price information in the cash market, or perhaps many other factors that would occur to an expert but not to us. Whatever the factors are, however, they should be analyzed, applied, and then carefully monitored in the implementation, to assure that the underlying principle is carried out:

namely, that if US price discovery is likely to be affected, then the US statutory and regulatory standards must apply.

We believe that adherence to this principle is critical to the members of APGA and to the millions of consumers of natural gas throughout the United States. It is the only way to ensure that pricing in this vital market remains efficient and fair. If price discovery moves to markets that can evade the carefully constructed U.S. regulatory system simply by artificial mechanisms such as the location of electronic equipment or the residency of executive personnel, then the door will be opened to price distorting conduct far beyond anything that the CFTC has uncovered in the past few years. The damage to U.S. consumers and U.S. vital markets would be great, and would fly in the face of the very purposes for which this Commission and the statutory structure it implements and oversees exists.

For these reasons, we urge the Commission to adopt the principle we offer and to instruct the staff to begin to implement its rules consistent with that principle.

I again thank the Commission for this opportunity to appear and testify today. APGA and I remain available to the Commission and its staff to answer any questions, provide any information, or otherwise assist as you move forward in the days ahead to address the critical issues raised by the Request for Comment and by today's hearing.