



**Before the
Commodity Futures Trading Commission**

**Statement of Steven Graham
on behalf of the
American Trucking Associations, Inc. (ATA)**

Hearing on Energy Position Limits and Hedge Exemptions

August 5, 2009

Chairman Gensler and Members of the Commission:

My name is Steven Graham and I am the Vice President of Schneider National, Inc., a trucking company headquartered in Green Bay, Wisconsin. Schneider National is a large truckload carrier that operates more than 12,500 trucks and employs more than 17,000 individuals. As a trucking company, we are dependent on an affordable, consistent supply of diesel fuel. In fact, our company purchases approximately 225,000,000 gallons of diesel fuel annually. Last year, Schneider National spent approximately \$855 million on diesel fuel, which was \$207 million more than we spent in the previous year. This dramatic year-over-year increase in the cost of diesel fuel was not only harmful to our company, but to the trucking industry and the U.S. economy as well.

Today, I appear before you representing not just Schneider National, but also the American Trucking Associations (“ATA”). ATA is the national trade association of the trucking industry. Through its affiliated state trucking associations, affiliated conferences and other organizations, ATA represents more than 37,000 trucking companies throughout the United States.

A. Overview of the Trucking Industry

The trucking industry is the driving force behind the nation’s economy. Trucks haul nearly every consumer good at some point in the supply chain. Few Americans realize that trucks deliver nearly 70 percent of all freight tonnage or that 80 percent of the nation’s communities receive their goods exclusively by truck.

The nearly 9 million people employed in trucking related jobs throughout the economy move approximately 10.2 billion tons of freight annually across the nation. Trucking annually generates \$660 billion in revenues and represents roughly 5 percent of our nation’s Gross Domestic Product.

The trucking industry consists of large national enterprises as well as a plethora of small businesses, all of whom operate in extremely competitive business environments with narrow profit margins. Roughly 96 percent of motor carriers have 20 or fewer trucks and are considered small businesses. This segment of the industry in particular has difficulty passing on rapid increases in fuel prices.

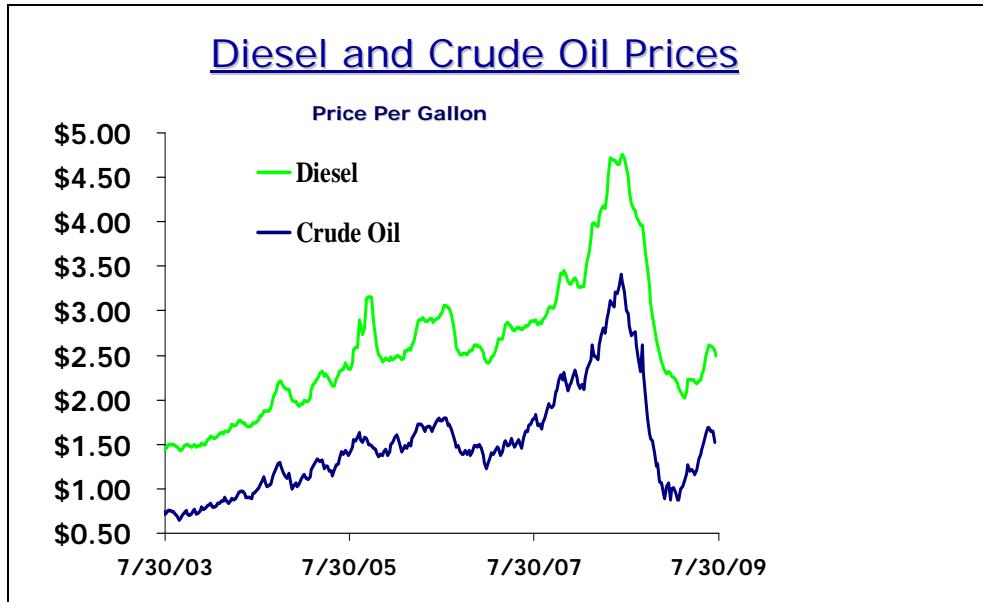
Diesel fuel is the lifeblood of the trucking industry. Each year, commercial trucks consume over 39 billion gallons of diesel fuel. This means that a one-cent increase in the average price of diesel costs the trucking industry an additional \$397 million a year in fuel expenses. Fleets spent an astonishing \$151 billion on fuel in 2008, a \$36 billion increase from 2007 and more than double the amount spent in 2004.

Sudden fluctuations in operating expenses, especially fuel, wreak havoc on the trucking industry. With the severe downturn in the economy and soft demand for freight transportation services, trucking companies are now struggling to survive. In 2007 and 2008, over 5,000 trucking companies with at least five trucks failed and thousands of drivers and other employees lost their jobs. In addition, a large number of companies that operate fewer than five trucks likely went under, while many owner-operators simply turned in their keys.

Trucking is a highly competitive industry with very low profit margins. This explains why many trucking companies are reporting that volatile fuel prices have greatly suppressed profits, if they are making a profit at all. Our industry cannot simply absorb this rapid increase in fuel costs. While some companies are able to pass some of these costs through to their customers, we rarely recoup the full additional expense. For this reason, many trucking companies use commodity derivatives to hedge the risk of increased fuel costs. Not only do high fuel prices devastate truckers, but their customers as well. Ultimately, the consumer is forced to pay higher prices for food, clothing and other basic necessities.

B. Why has the Price of Diesel Increased?

Diesel fuel is a commodity that is refined from petroleum. Like most commodities in a competitive marketplace, its price should be determined by supply and demand. The following chart demonstrates the close correlation between the price of petroleum and the price of diesel fuel.



The dramatic run-up in petroleum product prices last summer, including gasoline and diesel, was the result of a confluence of factors. Some of these factors directly impact supply and demand and a properly functioning market ensures that these factors are reflected in petroleum prices. However, according to several experts, market fundamentals, including the increased demand from China and India, supply disruptions in Nigeria and Venezuela, and the declining value of the U.S. dollar do not fully explain the dramatic rise and fall of the price of oil last year.¹ Added to these market fundamentals is the fact that there had been a significant increase in the amount of dollars invested in the petroleum derivatives market by non-commercial participants, leading us to conclude that this increased speculation may be partially responsible for the dramatic rapid increase in oil prices.

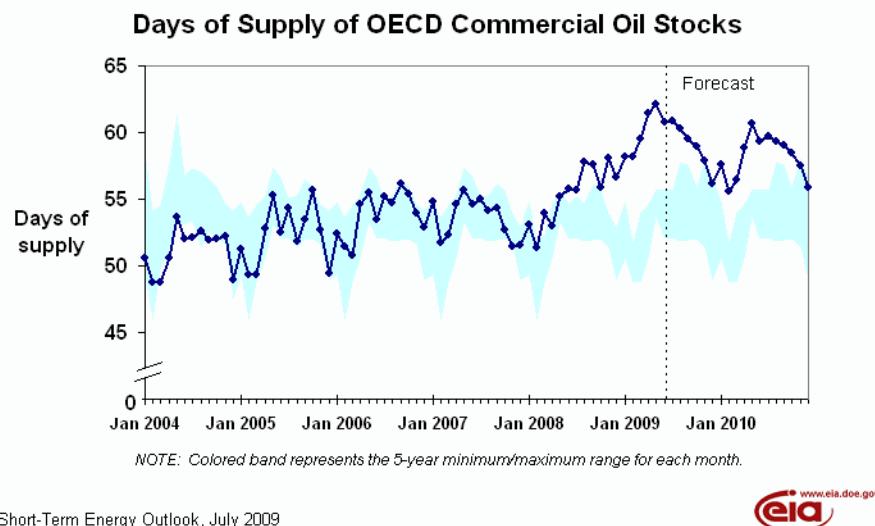
Between 2002 and 2007, the capital allocated to commodity index trading strategies rose from \$13 billion to \$260 billion.² The huge increase in dollars invested in the petroleum derivatives markets and the prevalence of exempt transactions and electronic exchanges that are not regulated by the Commodity Futures Trading

¹ See Michael Greenberger, Testimony Before the U.S. House Committee on Agriculture (February 3, 2009) (“Evidence adduced since the passage of this September 2008 legislation on the House floor has made it even clearer that excessive speculation in the unregulated energy and swaps markets has caused and continues to cause unnecessary and substantial volatility in the agriculture and energy markets.); see also Michael Masters, Adam White, *The Accidental Hunt Brothers*, available at <http://accidentalhuntbrothers.com>.

² We estimate that 3-4% of this increase is attributable to the appreciation in the price of the underlying commodities, while 96% represents an increase in investment in these derivative products. See Business Week (May 29, 2008) http://www.businessweek.com/magazine/content/08_23/b4087026916906.htm.

Commission (“CFTC” or “Commission”) has led many experts to conclude that the price of petroleum has departed from the fundamental market forces of supply and demand and has placed upward pressure on commodities prices.³

A more recent example of the disconnect between oil prices and market fundamentals occurred earlier this year. On February 12, 2009, oil prices hit a short term low of \$34 per barrel.⁴ The fall from the record highs experienced in the summer of 2008 was the result of significant demand destruction as a result of the global recession, a strengthening dollar, as well as the flight of speculators from the futures markets. Between February 12th and June 11th this year, the price of oil more than doubled to \$72.08 per barrel.⁵ Yet during this four month period, global demand remained weak and crude oil inventory in storage was well above average.⁶



During that same four month period the dollar fell relative to the Euro by 9%.⁷ Yet the 9% fall of the dollar does not fully explain the 100% increase in the price of oil.

³ *Id.*

⁴ *The Wall Street Journal*, section C (February 13, 2009).

⁵ *The Wall Street Journal*, section C (June 12, 2009).

⁶ Energy Information Administration, *Short-Term Energy Outlook*, p. 2 (July 2009) (“Compared with the year prior, world oil consumption was down an average of 3.0 million barrels per day [3.5%]. . . .”) (OECD commercial inventories held fairly steady during the second quarter of 2009 . . . but still remain well above the historic average.”).

⁷ During the same time period the Dollar actually strengthened against the Yen (up 7.4%), further indicating that the price of oil was being driven by speculators. *The Wall Street Journal* (February 13, 2009 and June 12, 2009).

Considering that demand remained weak and there were excess supplies of crude oil in inventory, excessive speculation is the only other variable left unaccounted for.

While we cannot quantify the extent to which speculation is responsible for the recent dramatic increase in the price of crude oil, we believe that excessive speculation is part of the problem. For this reason, we believe that the federal government should take steps to increase the transparency of the derivatives markets and establish reasonable position limits for non-commercial traders to prevent excessive speculation. Trading in derivative products and some level of speculation to ensure liquidity in the derivative markets is beneficial; however, the Commission should control excessive speculation that increases volatility or artificially inflates the price of the underlying commodity.

C. CFTC must act to Increase Market Transparency and Establish Aggregate Position Limits to Curtail Excessive Speculation while Preserving the Ability of Commercial Entities to Hedge Fuel Purchases

Reasonable position limits should be imposed that ensure the ability of consumers that physically possess the underlying commodity to effectively hedge market risk while limiting excessive speculation from investors that have begun using the derivatives markets for asset accumulation.

Many trucking companies hedge fuel through the use of a fuel surcharge, which is a pricing component of a freight contract that varies with the price of diesel fuel. A carrier like Schneider National is able to pass approximately 85% of fuel price increases on to its customers through the use of fuel surcharges. Roughly 15% of fuel price increases cannot be passed on to customers and Schneider National is able to hedge this portion (approximately 65 contracts per month) of its fuel price risk, typically using heating oil derivative contracts on the New York Mercantile Exchange (heating oil and diesel fuel prices are closely correlated). Hedging fuel has saved us money in some months and has cost us money in others, but we are strong advocates of hedging in order to provide purchase price stability of our single largest and most volatile cost component.

Because of fuel price volatility, shippers are showing interest in having motor carriers provide a fixed freight rate per mile, fuel included, for an extended period. In order to say yes to the customer, Schneider National would need to lay off the volatility risk by hedging all of the fuel required to serve that customer. At a future point, shipper aversion to fuel price volatility need could require Schneider National to hedge at a much higher rate than 15%.

We recognize that in order to facilitate our ability to hedge fuel, speculators must continue to participate in the market to provide an adequate level of liquidity. However, to ensure that speculation does not rise to a level that causes artificial upward pressure on the price of the underlying commodity, swaps and other over-the-counter transactions must be disclosed to increase transparency and reasonable aggregate position limits must be established to curtail excessive speculation.

We now turn our attention to the specific questions posed by the Commission with a view to helping determine the best way to establish aggregate position limits for energy commodities.

1. Applying position limits consistently across all markets and participants, including index traders, managers of Exchange Traded Funds, and issuers of Exchange Traded Notes;

One of the primary reasons to enact aggregate position limits is to prevent undue influence of an individual investor or group of investors on the price of the underlying commodity. Aggregate position limits would provide a check on market power and may reduce the impact of large institutional investors that use derivatives contracts as an asset accumulation tool. These investors typically take large long positions in oil and other energy commodities, which ultimately may drive up the spot price of the underlying commodity.

In order for position limits to achieve their desired effect of preventing unreasonable price fluctuations in the underlying commodities, the position limits must be aggregated and apply across all markets and all participants. The failure to include all markets in the position limit calculations will create loopholes in the regulatory scheme that could be exploited by entities seeking to circumvent the position limits. These loopholes will undermine the very purpose of establishing position limits.

That is not to say that each participant should be subjected to the same numerical position limit, as discussed in more detail in response to question number 5, below.

2. The effect of position limits on market function, integrity, and efficiency;

Assuming that the Commission establishes position limits at the correct level, such limits would improve market integrity and have a positive impact on the price discovery function. The correct level for position limits must allow some speculative activity to provide an adequate amount of liquidity in the derivatives market, but not so much that it increases volatility or drives the price of the underlying commodity in the spot market. While we do not have the expertise to pick an appropriate number for aggregate position limits, we discuss the methodology that the CFTC should consider in response to question number 5, below.

3. The effect of position limits on facilitating the risk management of clearinghouses;

We offer no opinion on the effect of position limits on facilitating the risk management of clearinghouses.

4. Whether the CFTC needs additional authority to implement such limits;

The CFTC is responsible for ensuring that the futures markets are free from excessive speculation that causes a disconnect between prices and market fundamentals. The Commodity Exchange Act clearly provides the Commission with the authority to enact reasonable position limits:

Excessive speculation in any commodity under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets or derivatives transaction execution facilities causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity. For the purpose of diminishing, eliminating, or preventing such burden, the Commission shall, from time to time, after due notice and opportunity for hearing, by rule, regulation, or order, proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility as the Commission finds are necessary to diminish, eliminate, or prevent such burden.⁸

While the CFTC has the necessary authority to establish position limits as described in response to Question 5, below, we offer no opinion on whether CFTC has the legal authority to implement other measures that may be necessary to curb excessive speculation in energy commodities.

5. What methodology the Commission should use to determine position limit levels for each market.

Due to the pervasive impact that crude oil prices have on all segments of the economy, it may be necessary to prioritize the regulation of this commodity as CFTC moves to impose position limits on energy commodities.⁹

⁸ 7 U.S.C §6a(a).

⁹ We note that our experience with futures markets is limited to the derivative products that are used to hedge diesel fuel prices. For this reason, our response on the methodology that the Commission should use to establish position limit levels for each market is limited to the crude oil and heating oil markets, as these are the futures markets that are used to hedge diesel fuel.

The establishment of aggregate position limit levels will require a series of steps - the first of which is to quantify and understand the amount of influence that over-the-counter and other off-exchange contracts have on the market. Requiring reporting of these “dark” transactions will provide the Commission with valuable information on the current positions of entities that participate in the derivatives markets and allow it to establish appropriate position limits that curb excessive speculation while maintaining market liquidity.

CFTC should establish a separate Advisory Committee to continually analyze the data generated above and make recommendations concerning adjustments to the appropriate amount of speculative investment that should occur in the market and the aggregate individual position limits that would ensure adequate liquidity while preventing excessive speculation. In selecting the members of an Advisory Committee, it is important that all interests be represented; however, the commercial participants (*i.e.*, those that take possession of the underlying commodity and use the derivatives markets to hedge price changes in the commodity) should comprise the majority of the Advisory Committee. Electronic exchanges, swaps dealers, investment bankers, hedge funds, and other financial institutions should have representation on the Advisory Committee, but should comprise a minority of the committee, since these entities profit from increased activity in the commodities markets and speculative bubbles.

- *What quantitative measures should be used in setting limits on the size of an individual trader’s position?*

In establishing aggregate position limits, CFTC must distinguish between commercial participants that take physical possession of the underlying commodity and non-commercial participants that do not take possession of the commodity. The distinction between commercial and non-commercial participants is important to ensure that trucking companies who are dependent upon petroleum products are able to hedge their exposure to changes in petroleum prices; and that they may continue to offer their customers/shippers fixed price transportation contracts and lay off or hedge the exposure that comes with providing a fixed price.

- (A) Limits for Non-Commercial Participants - The Commission, with input from the Advisory Committee, must establish aggregate position limits for non-commercial participants (speculators) across all markets and trading platforms. These limits should be adjusted periodically, as derivatives markets evolve and the Commission gains more experience with the appropriate position limits necessary to provide liquidity to the market while curtailing excessive speculation that could lead to the formation of a speculative bubble and influence the price of the commodity. These limits must be enforced through random audits as well as targeted investigations.

(B) Limits for Commercial Participants – The first order of business in establishing appropriate limits for commercial participants is to define who meets the definition of a commercial participant (*e.g.*, bona fide hedger). For the petroleum markets, a commercial participant must take physical possession of a petroleum product. To facilitate hedging of diesel fuel, it is important to recognize that while trucking companies physically possess diesel fuel, they hedge diesel fuel by participating in the futures markets for heating oil and crude oil, yet they do not ordinarily possess crude oil or heating oil. Recognition of these hedging surrogates is important in determining the status of various commercial participants. At the same time, those that seek to hedge against inflation by purchasing petroleum derivatives contracts should not be considered commercial participants, as these so-called hedgers are more akin to pure speculators. We also believe that the higher position limits applicable to commercial participants should consider the issue of whether the entity establishes a long or short position in line with its commercial interests. For example, a trucking company hedges against the price of fuel going up to protect its commercial interest and is therefore long oil. Should that trucking company take a short position in oil, that company should be treated as a non-commercial participant, since that position is speculative, rather than a bona fide hedge position. Similarly, a commercial entity that stores oil and hedges against the risk of falling oil prices by taking a short position should not be entitled to larger position limits when they choose to speculate by going long.

The next step in setting position limits for commercial participants is to recognize that each participant has a different need to hedge a different amount of product based upon their physical possession of the underlying commodity. In other words, a trucking company that consumes 1,000,000 gallons of diesel fuel per month would need to purchase more futures contracts than a trucking company that consumes only 10,000 gallons of diesel fuel per month. For this reason, position limits applicable to commercial participants should vary based upon their physical consumption of the underlying commodity over a set period of time. Because a commercial participant's physical possession and the need to hedge will vary based upon seasonal demand, the organic growth of the company or due to acquisitions and divestitures, the position limits applicable to commercial participants should be allowed to vary from month-to-month.

Enforcement of the position limits for commercial participants must take into consideration the transaction costs associated with hedging. While recordkeeping requirements will be necessary for CFTC to enforce position limits across all entities that participate in the futures markets, CFTC should take care to avoid commercial participant reporting requirements that are so onerous that they increase the cost of hedging for commercial participants.

(C) Limits for Swaps Dealers and Market Makers – In establishing position limits, the Commission should treat over-the-counter derivative dealers as non-commercial participants, since they do not take possession of the physical commodity. However, these individuals will necessarily exceed the non-commercial speculative position limits depending upon the number and types of clients they service. For this reason, these entities' position limits should rise and fall depending upon the trades they exercise for their clients. A broker/dealer that purchases contracts for its clients should be subjected to position limits that correspond to the limits imposed upon their clients. The failure to allow this could compromise the liquidity necessary for an efficient futures market and dramatically increase the cost of hedging for commercial participants. In addition, these entities should be able to speculate for their own account, but only to the extent permitted by the non-commercial position limits established by the CFTC. Finally, it is critically important that the investment banks, hedge funds, swaps dealers and other “market makers,” whose analysts offer predictions on commodity prices be required to prominently disclose the net positions that they and their customers hold at the same time that the analyst prediction is offered. The concept of establishing a Chinese wall between a firm’s analysts and trading desks has not worked and these entities should not be allowed to manipulate the market by holding a position and then issuing an analysis that favors their position.

In each of these cases it is important to ensure that all over-the-counter or swaps trades are appropriately disclosed so that the CFTC can monitor whether the shear volume of these trades are putting upward pressure on current prices and take appropriate action, if necessary. We share the concerns of other commercial participants with respect to the positions taken by index funds. While we are not alleging that these funds are manipulating the market and intentionally driving the price higher, we believe that the cumulative impact of their enormous long-only positions has contributed to the disconnect between market prices and market fundamentals.

- *Should limits be established by percentage or proportion of the open interest of the market or by fixed number of allowed contracts?*

To facilitate the allocation of position limits between commercial and non-commercial participants, as described above, we believe that position limits should be based upon a fixed number of allowed contracts. We believe that the Commission should retain the authority to vary the number of allowable contracts periodically, in order to ensure the appropriate amount of liquidity while curbing excessive speculation. In calculating appropriate position limits for non-commercial participants, CFTC would need to examine the open interest of the market, but ultimately should establish a fixed number of allowed

contracts.¹⁰ Using a fixed number of allowed contracts will facilitate compliance and enforcement of the position limits.

- *Should limits apply in all months combined, in individual months, and in the delivery month?*

Position limits should apply in all months combined, individual months, and may need to be further limited in the delivery month to prevent manipulation and ensure convergence of the future price and the spot price.

- *How should spread trades be incorporated in this calculation?*

In examining spread trades the Commission should look at the entity's net position.

6. *Should the Commission limit the aggregate positions held by one person across different markets?*

Yes. The CFTC should limit the aggregate position held by one person across all trading venues. The failure to do so would create a regulatory loophole that would completely undermine the purpose of establishing position limits. There must be no exemptions from the aggregate position limits outlined above in response to question 5.

7. *Should exemptions from position limits be permitted for anyone other than bona fide hedgers for the conduct and management of a commercial enterprise?*

No. Any exemptions to position limits could be exploited by those entities that seek to speculate in the futures markets. Notwithstanding, this general statement, we believe that there should be separate position limits applicable to commercial, non-commercial, and broker/dealers, as described in response to Question 5, above.

- *The statute states exemptions should only be granted to bona fide hedgers. What should the qualifying factors be for an entity to meet the definition of a bona fide hedger?*

A bona fide hedger must meet the definition of a commercial participant. They must take physical possession of the underlying commodity. We caution the Commission on adopting a broad definition of bona fide hedger that allows entities to use futures contracts as an asset accumulation tool or to provide a general hedge against inflation. Entities that wish to use futures contracts to hedge inflation, devaluation of the dollar, or as a general investment tool must be

¹⁰ The actual number of contracts comprising the non-commercial participant position limit could vary annually based upon the overall percentage of open interest in the market.

- treated as speculators and subjected to the position limits established for non-commercial participants.
8. *Finally, if you believe the Commission should not set position limits on energy contracts, please address the inconsistent approach for other commodities with a finite, physically deliverable supply, such as certain agriculture commodities.*

This question is not applicable, as we strongly believe the Commission should establish position limits on all energy contracts.

* * * *

It is clear that our energy crisis is a complex problem that requires a comprehensive solution. A comprehensive energy policy that focuses on increasing petroleum supplies and incentivizing fuel conservation measures is necessary to favorably impact market fundamentals. However, ensuring a transparent orderly derivatives market that is free from “excessive speculation” also is necessary to reduce volatility and ensure that current prices are connected to the market fundamentals of supply and demand.

ATA appreciates this opportunity to offer our insight into a potential means to curb excessive speculation in the energy commodities markets. Increasing market transparency and establishing reasonable position limits that distinguish between commercial and non-commercial participants will reign in excessive speculation.

Most importantly, we note that the recommendations to increase oversight and establish reasonable position limits for non-commercial traders are remedies that, if implemented correctly, have no potential downside that we can discern. Under a worst case scenario, the transparency of the market is improved, but the price of oil remains unaffected. More optimistically, these remedies would reduce any speculative bubbles, restore investor confidence in the futures markets, and limit the participation of asset accumulators in the futures markets resulting in a relatively quick reduction in the price of oil and a stronger link between commodity prices and market fundamentals.

If you have any questions concerning the issues raised in this testimony, please contact Richard Moskowitz, American Trucking Associations, at (703) 838-1910 or rmoskowitz@trucking.org

Respectfully submitted,

/s/

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