Testimony of John Hyland, Chief Investment Officer
United States Commodity Funds LLC
Before the Commodity Futures Trading Commission
Concerning Energy Position Limits and Hedge Exemptions
August 5, 2009

Good morning Chairman Gensler and Commissioners.

I appreciate the opportunity to speak with you today on behalf of United States Commodity Funds LLC ("USCF"), a commodity pool operator registered with the Commodity Futures Trading Commission ("CFTC"), that manages several exchange traded commodity pools, including the United States Oil Fund, LP ("USO") and the United States Natural Gas Fund, LP ("UNG") (together with USCF's other commodity pools, the "Funds").

In recent months a great deal of discussion has taken place with respect to the role and effect of various participants in the energy markets. Many of the reports on this topic have cited the activities of large, unleveraged and passive index and single commodity tracking funds, such as USO and UNG, in an attempt to explain recent volatility in energy markets. We believe many published reports concerning USO and UNG have mischaracterized the impact of passive index funds on energy markets.

As price takers—merely tracking the price movement of their respective commodities—the Funds' investment strategies preclude them from acting in a way that could lead to the manipulation of prices or cornering of the futures market. Empirical data shows that the Funds' activities in the futures market have resulted in little or no price disruption even as the overall size of the Funds' positions have increased dramatically. Instead of disrupting the futures market, the Funds provide a steadying force by adding significant liquidity to the market. In 2008, nearly 325,000 individual investors gained access to the futures market through investments in the Funds. These investors were able to enter the futures market without the traditional settlement risk attendant to futures contracts acquired on a leveraged basis, due to the unleveraged nature of the Funds' investments. For 2009, the total number of shareholders using this method is likely in excess of 600,000 investors.

Rather than acting as a source of risk, the Funds provide investors with a transparent, highly regulated, and unleveraged vehicle through which to hedge their pre-existing price risk in commodities. Whether this risk arises from direct economic interests in commodities, or from broader inflationary or other investment risks, the Funds provide an important hedging alternative to individual investors, without increasing market risk or otherwise adversely affecting the futures market. Although the futures positions held by the Funds may appear to be large in relation to each Fund as the legal holder of such positions, these investments represent the aggregation of demand from tens of thousands of individual investors seeking to reduce their financial risk through hedging in the commodity futures market.

We welcome this chance to both clarify the role that these funds play in energy markets and to discuss the appropriate regulation of these widely-used investment vehicles.

I. Overview of USCF Funds

As a registered commodity pool operator, USCF is general partner of and manages the United States Oil Fund, LP, the United States Natural Gas Fund, LP, the United States 12 Month Oil Fund, LP, the United States Gasoline Fund, LP, the United States Heating Oil Fund, LP, and the United States Short Oil Fund, LP. Each of the Funds is an exchange-traded commodity pool that invests in futures contracts for energy commodities with the investment objective of having the net asset value ("NAV") of the units of each Fund reflect changes in percentage terms of the price of a given commodity futures contract. The specific commodity focus and investment strategy of each Fund varies; however, the structure and method of investing in all of USCF's Funds is identical. Units of each of the Funds are listed on the NYSE Arca, Inc. ("NYSE Arca").

The Funds are Highly Regulated. The structure of the Funds places them in a multi-tiered regulatory structure. In addition to regulation of USCF as a commodity pool operator by the CFTC and National Futures Association, the sale of Fund securities on the NYSE Arca subjects each Fund to comprehensive federal securities regulation by the U.S. Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA") and NYSE Arca. These regulatory organizations review the offering documents of each Fund and provide ongoing regulatory oversight of the Funds' operations.

The Funds are Widely Held by the Public. Each of the Funds has a large number of investors. The two largest funds, USO and UNG, each have hundreds of thousands of shareholders. For calendar year 2008, the Funds had a combined 325,000 investors. For 2009, management estimates that there are over 600,000 shareholders in all of the Funds. Management's analysis of prior year shareholder data, derived from tax reporting information, suggests that between 75%-90% of all shareholders, depending on the Fund, could be deemed to be individual, "retail" investors, *i.e.*, not institutions or investment funds.

Management further believes that the shareholdings in the Funds tend to be very widely held. Based on the absence of SEC required 13G and 13F filings, no investor, to the Funds' knowledge, currently holds more than 5% of the units outstanding of any Fund. Ownership above the 5% level has occurred on an extremely limited basis, typically when a Fund initially offered its units to the public.[1] As is true with all exchange traded funds ("ETFs"), all shares are held in "street name" at brokerage firms. There does not appear to be any large concentration of shares being held at any single brokerage firm. In fact, the brokerage firms that typically show up on The Depository Trust Company ("DTC") reports as holding the largest number of Fund shares at any one time tend to be the large discount brokerage firms such as Charles Schwab and Fidelity, further suggesting widespread share holdings due to the fact that these firms tend to cater to a predominantly retail client base.

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[1] Since each of the Funds are registered under the Securities Exchange Act of 1934 ("Exchange Act"), investors holding 5% of more of a Fund's units are required to disclose their holdings and intentions under Section 13 of the Exchange Act.

The Funds are not Leveraged. The futures trading activity of each Fund is unleveraged, as all futures positions are fully collateralized. Each time a Fund receives a purchase order for a Creation Basket the Fund purchases futures contracts in the appropriate commodity that have an aggregate market value that approximates the purchase price received by the Fund for such Creation Basket. After transferring the required margin for the futures contracts purchased with its futures commission merchant, the Fund then invests the remainder of its proceeds from the Creation Basket in short term obligations of the United States of two years or less ("Treasuries"), cash and/or cash equivalents. Through this process each Fund ensures that the value of its Treasuries, cash and cash equivalents, whether held by the Fund or posted as margin or collateral, at all times approximates the aggregate market value of its obligations under its futures contracts.

The Funds' Pricing and Investments are Transparent. Each of the Funds is highly transparent. In addition to their prospectuses/disclosure documents and periodic reports required by the SEC and the NFA, the Funds provide the following information on their websites as of the end of the most recent NYSE Arca trading day: (i) current NAV of the Fund; (ii) its units' closing price; (iii) any premium/discount on the units; (iv) units outstanding; (v) daily holdings of each of the Funds' investments and pending trades in such investments; (vi) creation and redemption basket activity; and (vii) recent performance information. Information on the Funds is also available on the NYSE Arca website, which publishes a wide variety of Fund data, including: (i) intra-day and closing prices; (ii) daily trading volume; and (iii) previous day's closing price.

In addition, the Funds publish their anticipated roll dates on their websites, thus providing full transparency to the market concerning these transactions. Publishing the roll dates ensures that market arbitrage opportunities will prevent speculators in the market from successfully front-running the timing of a Fund's roll, which is the type of activity that carries the risk of disturbing futures markets.

A Fund's Units are Priced by the Value of Its Assets and the Market. The Funds' units are created or redeemed only in blocks called Creation Baskets and Redemption Baskets, respectively, pursuant to an effective registration statement filed with the SEC. Only persons authorized by the Funds ("Authorized Purchasers") may purchase or redeem Creation or Redemption Baskets from a Fund.[2] The amount of the purchase payment for a Creation Basket is equal to the aggregate NAV of units in the Creation Basket. Similarly, the amount of the redemption proceeds for a Redemption Basket is equal to the aggregate NAV of units in the Redemption Basket. The purchase price for Creation Baskets, and the redemption price for Redemption Baskets is the actual NAV calculated at the end of the business day when an order for a purchase or redemption is accepted by a Fund. The NYSE Arca publishes an approximate NAV intra-day based on the prior day's NAV and the current price of each Fund's benchmark

[2] Authorized Purchasers do not receive from the Funds, USCF or any of their respective affiliates any fee or other compensation in connection with the sale of the units, although Authorized Purchasers may receive commissions and/or fees from investors who purchase the units, and may have gains or losses from their resales or redemptions of units purchased from a Fund.

commodity futures contract, but the basket price is determined based on the actual value of the assets when the NAV is calculated at the end of the day.

Authorized Purchasers, who are registered broker-dealers and participants in DTC, sell units acquired through Creation Baskets to the public at prices that are expected to reflect, among other factors, the trading price of the units on the NYSE Arca, the NAV of the particular Fund at the time the Authorized Purchaser purchased the Creation Baskets and the NAV at the time of the offer of the units to the public. Baskets are generally redeemed when the market price per unit is at a discount to the NAV per unit and are purchased when the market price per unit exceeds the NAV per unit. Retail investors seeking to purchase or sell units on any day are expected to effect such transactions in the secondary market, on the NYSE Arca, at the market price per unit, rather than in connection with the creation or redemption of baskets.

II. Market Impact of USO and UNG

In recent months, a number of published reports have attempted to make the case that last year's run-up in crude oil prices and their subsequent fall and recent rise this year, as well as last year's run-up in natural gas prices and their subsequent fall lasting into this year, were the result of the investments made in the crude oil and natural gas futures markets by large, unleveraged and passive index funds. Many of these reports cited USO and UNG as examples of such funds whose buying and selling activities were alleged to be causing unusually wide swings in crude oil and natural gas prices.

The management of USO and UNG believes these reports significantly mischaracterize the impact of these funds on the market prices of crude oil and natural gas as highlighted by the data provided below.

a. Impact of USO on the Crude Oil Futures Market

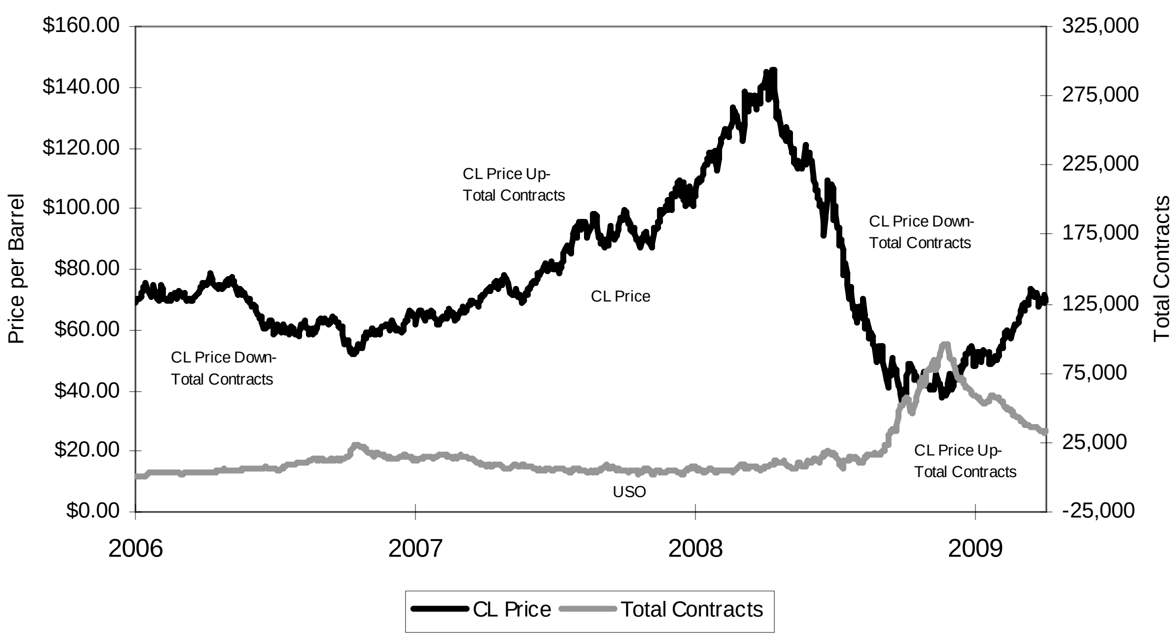
Many of the articles published on this topic have stated that USO's large size, and the fact that it was the first publicly offered exchange traded vehicle that offered exposure to crude oil futures, made it a key factor in the rapid rise of crude oil prices in 2008. Furthermore, several articles continue to make such claims for market activity continuing into 2009. However, the management of USO believes that readily available information from USO's website and other widely available financial news and data sources indicate that many or most of these claims lack merit.

The chart below compares the price of the New York Mercantile Exchange ("NYMEX") front month light, sweet crude oil contract ("CL") to the actual size of USO's crude oil futures contracts holdings. The time period covered by this chart runs from USO's inception date, April 10, 2006, to June 30, 2009. The CL price, shown on the left hand axis is in dollars per barrel. USO's crude oil futures contract holdings, shown on the right hand axis, are in 1,000 barrel contract equivalents.

The data shows that during the run-up in crude oil prices from January 2007 and $53 a barrel price, to July 2008 and roughly $145 a barrel, USO's holdings in crude oil futures contracts declined. At the January 2007 low, USO owned 23,557 crude oil futures contracts. At the July 2008 high, USO's holdings had fallen almost 60% to 9,825. Furthermore, the large increase in crude oil contracts held by USO occurred in late 2008 and continued to February 2009, coinciding with a period of time when crude oil prices trended lower, not higher. The data presented in the chart below does not support the theory that USO's large scale purchasing of crude oil futures contracts drove prices significantly higher precisely because crude oil prices fell during that same time period.

Finally, the most recent increase in crude oil prices, which began in February of 2009 and continues to the present, coincides with a period in which USO was once again a large scale seller of futures contracts, not a buyer. During the most recent run-up in prices, USO has steadily sold off 65% of its peak level holdings. The data presented in the chart does not support the theory that USO's activities drove prices significantly higher in recent months.

Crude CL Price (Left-hand Axis) vs USO's Total Contract Holdings (Right-hand Axis)
(since inception 4/06)



Source: United States Oil Fund, LP

In sum, management strongly believes that the activities of USO have not caused the extreme swings in the price of crude oil as alleged by some published articles during the above-noted time frame.

b. Impact of UNG on the Natural Gas Futures Market

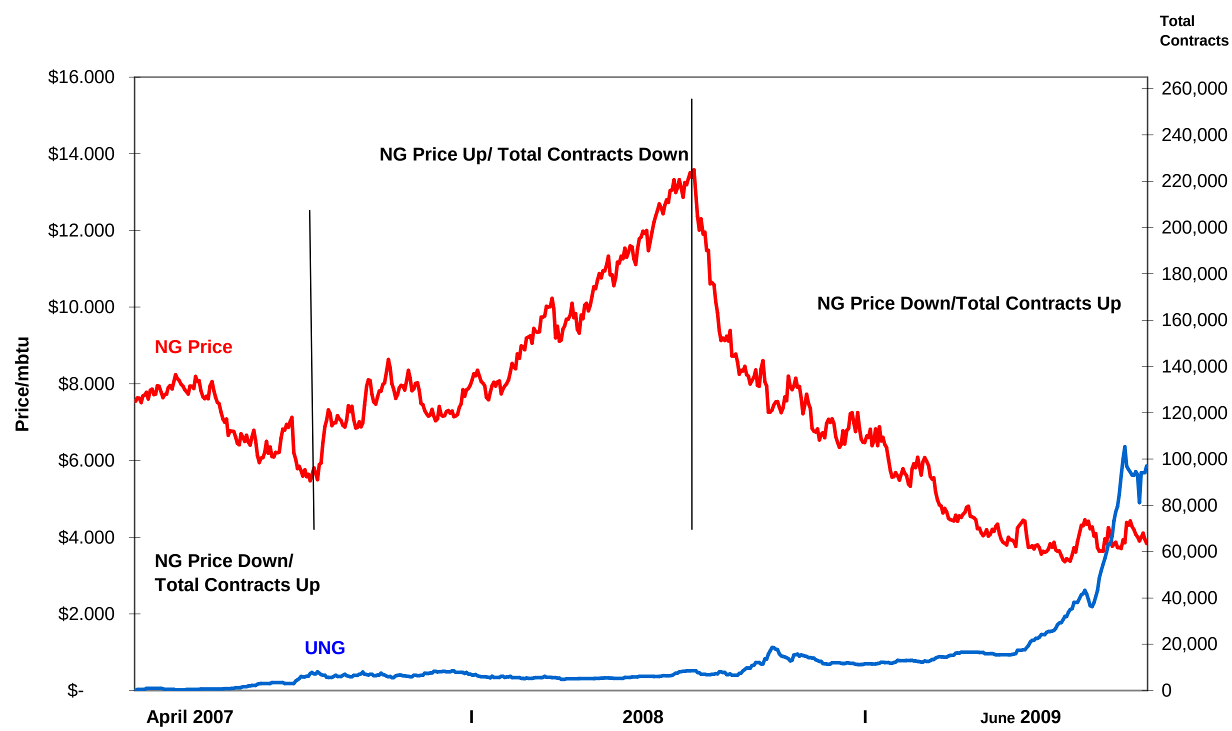
In a similar manner as the articles discussing the impact of USO on energy markets, many other articles have stated that UNG's large size, and the fact that it was the first publicly offered, exchange traded vehicle that offered exposure to natural gas futures, made it a key factor in the rapid rise of natural gas prices in 2008. Furthermore, several articles continue to make such claims for market activity continuing into 2009. However, the management of UNG believes that readily available information from UNG's website and other widely available financial news and data sources indicate that many or most of these claims lack merit.

The chart below compares the price of the NYMEX front month natural gas contract ("NG") to the actual size of UNG's natural gas futures contracts holdings. The time period covered by this chart runs from UNG's inception date, April 17, 2007, to June 30, 2009. The NG price, shown on the left hand axis, is in dollars per Million BTU ("mbtu"). UNG's natural gas futures contract holdings, shown on the right hand axis, are in 10,000 mbtu contract equivalents.

The data shows that during the run-up in natural gas prices during the time period of September 2007 and $5.50 mbtu, to July 2008, and roughly $13.50 mbtu, UNG's holdings in natural gas futures contracts were essentially flat. UNG owned 8,093 contracts on September 7th, 2007. The Fund owned 8,587 contracts on July 3, 2008. UNG's management does not believe that this data supports the notion that UNG's investing activities could have been a driving force behind the increase in natural gas prices over this time period.

More recently, UNG has seen a large increase in the number of natural gas contracts owned by it. However, this increase occurred in 2009 during a period of time in which natural gas prices have trended lower, not higher. UNG's management believes the data presented in the chart does not support the theory that UNG's purchasing of natural gas futures contracts has driven prices significantly higher because natural gas prices did not rise significantly higher during the same time period.

Natural Gas Futures Price (left hand axis) vs UNG's Total Contract Holdings (right hand axis)
(since inception, 4/07, to 6/09)



Note: Contracts in 10,000 mbtu equivalents

Source: United States Natural Gas Fund, LP

In sum, management strongly believes that the activities of UNG have not caused the extreme swings in the price of natural gas as alleged in some published articles during the above-noted time frame.

III. Position Limits and Hedge Exemptions

We understand that the CFTC is currently reviewing its regulation of energy markets and, in particular, the application of speculative position limits and hedge exemptions to energy commodities. We are of the view that current regulation of the energy commodity positions held by investors in futures by the exchanges is sufficient. However, if it is determined that speculative limits akin to those applied to agricultural commodities are deemed appropriate for the energy markets, in light of the role passive index funds and single commodity funds like USO and UNG play in energy market, we believe that the CFTC should (i) extend the bona fide hedge exemption applicable to certain agricultural commodities to other physical commodities currently subject to exchange position limits and accountability levels; (ii) codify the CFTC's no-action position with respect to the activities of index-based tracking funds in any future regulation of the commodity futures market; and (iii) extend futures position relief to exchange-traded commodity funds tracking single commodity benchmarks, such as the Funds.

a. Extension of the Bona Fide Hedge Exemption

CFTC regulations currently provide a bona fide hedge exemption that allows qualifying counterparties to enter into transactions in excess of speculative position limits for futures and options contracts on certain agricultural commodities established pursuant to Section 4a(a) of the Commodity Exchange Act ("CEA").[3] This exemption allows for the orderly offsetting of risk through the futures markets by parties engaged in legitimate hedging activities. In the years following codification of the exemption, the CFTC adapted the bona fide hedging exemption to developments in the commodity futures markets both by granting hedge exemptions, and by providing no-action relief in conformity with the exemption. Without the bona fide hedge exemption, many market participants would be unable to engage in risk mitigation activities due to stringent position limits on commodity futures contracts.

We believe that the CFTC should extend the bona fide hedge exemption, or any similar risk management exemption developed by the CFTC, to the broader commodities market, including those energy commodities invested in by the Funds. Regardless of whether position and accountability limits for energy commodities continue to be dictated by individual exchanges, or are directly regulated by the CFTC, participants in these markets would benefit from the ability to mitigate their risks through hedging transactions unencumbered by speculative position or accountability limits. Additionally, we believe that the activities of the Funds, as detailed further below, provide a risk mitigation tool for individual investors that merits inclusion in any exemption provided by the CFTC to hedge counterparties.

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[3] *See* CFTC Regulation § 1.3(z).

b. Codification of the CFTC's Current No-Action Position

The CFTC staff has granted no-action relief to two index-based funds from the speculative position limits on certain agricultural commodities established by the CEA.[4] We believe these letters provide useful and appropriate precedent in establishing an exemption for passive index funds and single commodity funds like USO and UNG, if such limits are imposed on the energy commodity markets. Although these index-based funds did not expressly qualify for the bona fide hedging exemption set forth in CFTC regulation 150.3(a)(1), the CFTC determined that these funds "represented a legitimate and potentially useful investment strategy" [5] and thus extended no-action relief from CFTC position limits, subject to certain conditions aimed at protecting futures markets.

In granting relief to index-based funds, the CFTC staff highlighted a number of attributes found in index-based funds that provide strong support for granting relief to such funds similar to the relief granted to qualified bona fide hedgers. These attributes, stated in the no-action letters as conditions for receiving relief, include (i) passive tracking of a benchmark; (ii) unleveraged futures trading activity; (iii) excess positions not affecting the spot month futures contract; (iv) high level of transparency; (v) extensive federal and self-regulatory oversight; and (vi) lack of price exposure to the fund.[6]

We agree with the CFTC staff that the unique features of index-based funds, as well as single commodity tracking funds (see discussion below), allow these funds to actively participate in the commodity futures market while still providing substantial protections and full disclosure to market participants and the investing public, such that their activities do not trigger the concerns that strict futures position limits are intended to address. Thus we believe that the CFTC should codify its no-action position with respect to index-based commodity tracking funds and extend such position to single commodity tracking funds such as the Funds.

c. Extension of Futures Position Relief to Single Commodity Tracking Funds

As stated above, we strongly encourage the CFTC to codify is no-action position with respect to the hedging activities of index-based tracking funds. This position, however, should not be limited to index-based funds, but rather extended to all commodity tracking funds with the characteristics of hedgers in the energy markets. The CFTC staff identified a number of these characteristics in the no-action relief granted to index-based funds. Nearly all of the conditions upon which the CFTC staff premised its relief for index-based funds are already operational or structural characteristics of the Funds. Thus we believe that any new regulatory structure developed by the CFTC should extend the same type of hedge exemption treatment to the Funds as was previously granted for index-based funds.

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[4] CFTC Letter 06-09, April 19, 2006; CFTC Letter 06-19, September 6, 2006.

[5] *Concept Release on Whether to Eliminate the Bona Fide Hedge Exemption for Certain Swap Dealers and Create a New Limited Risk Management Exemption From Speculative Position Limits* ("Concept Release"), 74 FR 12282, footnote 15, March 24, 2009.

[6] *See* CFTC Letter 06-09 at 4; CFTC Letter 06-19 at 5-6.

Just as the price exposure faced by index-based funds results from a promise or obligation to track an index, each of the Funds is subject to similar exposure resulting from its commitment to track changes in the price of a futures contract relating to a specified commodity. Meeting this objective may require both index-based or commodity futures contract-tracking funds to invest in futures positions that exceed current or future CFTC limits. However, offsetting this type of price exposure does not currently fall within the bona fide hedging exemption. The CFTC staff effectively addressed this problem for index-based funds by granting them relief from speculative position limits in its two no-action letters. In these no-action letters, the CFTC staff identified several attributes of the index-based funds that provided sufficient protections to the futures market and thus were required in order to receive the requested relief.

The following discussion outlines how the Funds already meet the key conditions upon which relief was granted by the CFTC staff for index-based funds (using the conditions as stated in the CFTC staff letters).

i. The futures trading activity passively tracks a widely recognized commodity index.[7]

Each of the Funds is passively managed and employs a "neutral" investment strategy intended to track changes in the price of a benchmark commodity regardless of whether the price goes up or down. This strategy means that the Funds, just like the index-based funds provided no-action relief, do not seek to generate positive returns in all market conditions based on the individual investment decisions of their CPO. Thus the Funds are not actively managed and do not engage in speculative activities in the futures market.

Additionally, the trading activities of the Funds occur in widely recognized commodity futures contracts. The commodities futures tracked by the Funds are each traded on the NYMEX, and represent some of the most highly traded and liquid commodity futures contracts in the world. These commodities include the NYMEX futures contracts for (i) light, sweet crude oil delivered to Cushing, Oklahoma; (ii) natural gas delivered to Henry Hub, Louisiana; (ii) RBOB gasoline for delivery to the New York harbor; and (iv) heating oil (also known as No. 2 fuel) delivered at the New York harbor.

ii. The futures trading activity is unleveraged.[8]

The futures trading activity of each Fund is unleveraged, as all futures positions are fully collateralized. Each time a Fund receives a purchase order for a Creation Basket the Fund purchases futures contracts in the appropriate commodity that have an aggregate market value that approximates the purchase price received by the Fund for such Creation Basket. After transferring the required margin for the futures contracts purchased with its futures commission merchant, the Fund then invests the remainder of its proceeds from the Creation Basket in short

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[7] *See* CFTC Letter 06-09 at 4; CFTC Letter 06-19 at 5.

[8] *See* CFTC Letter 06-09 at 4; CFTC Letter 06-19 at 5.

term obligations of the United States of two years or less ("Treasuries"), cash and/or cash equivalents. Through this process each Fund ensures that the value of its Treasuries, cash and cash equivalents, whether held by the Fund or posted as margin or collateral, at all times approximates the aggregate market value of its obligations under its futures contracts.

iii. Positions in excess of the speculative limits are not carried into the spot month.[9]

None of the Funds intends to take delivery of the commodity underlying its futures contracts. Instead, each Fund sells its near month contracts and purchases corresponding next month contracts over a one to four day period beginning on the day that is two weeks prior to the expiration of the near month contract.[10] Rolling contract positions in this manner provides the following two significant protections to the futures market: (i) by rolling out of their front month contracts two weeks prior to expiration, the Funds protect the futures market from any unexpected price fluctuations that could occur if such trades were performed during the final days of the contract month when the risk of price distortion is particularly high; and (ii) by rolling out of their positions over a four-day period the larger Funds are able to trade out of large overall positions in the front month contract without upsetting the market by executing all trades on the same day.

iv. Both the index and the fund are highly transparent.[11]

Each of the Funds is highly transparent. The Funds provide the following information on their websites as of the end of the most recent NYSE Arca trading day: (i) current NAV; (ii) closing price; (iii) premium/discount; (iv) shares outstanding; (v) daily holdings of each of the Funds' investments and pending trades in such investments; and (vi) recent performance information. Information on the Funds is also available on the NYSE Arca website, which publishes a wide variety of Fund data, including: (i) intra-day and closing prices; (ii) daily trading volume; and (iii) previous day's closing price.

In addition, the Funds publish their anticipated roll dates on their publically-accessible websites, thus providing full transparency to the market concerning their transactions. Publishing the roll dates ensures that market arbitrage opportunities will prevent speculators in

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[9] *See* CFTC Letter 06-09 at 4; CFTC Letter 06-19 at 6.

[10] Currently, the only Funds that do not sell their contracts over a four-day period are the United States 12 Month Oil Fund, LP ("US12OF"), the United States Gasoline Fund ("UGA") and the United States Heating Oil Fund ("USHO"). Unlike the other funds managed by USCF, which generally hold all of their futures contracts in the near month and then roll all of these contracts into the next month contract, US12OF holds futures contracts spread over a 12 month period. When US12OF rolls out of its near month contract, it purchases new positions in the thirteenth month contract. As a result, US12OF's roll does require extension over a four-day period in order to ensure that no disturbance in the market occurs. At this time, UGA and USHO do not roll over a four-day period due to their small size. However, should these two funds increase to a size that requires them to hold more significant amounts of futures contracts they will be moved to a four-day roll.

[11] *See* CFTC Letter 06-09 at 4; CFTC Letter 06-19 at 6.

the market from successfully front-running the timing of a Fund's roll, which is the type of activity that carries the risk of disturbing futures markets.

> *v. The fund is subject to unique federal and self-regulatory oversight by virtue of the shares being listed on the NYSE Arca, and thereby subject to regulation by the SEC and FINRA, as well as to regulation by the CFTC and the NFA.*[12]

The structure of the Funds places them under the same multi-tiered regulatory structure as the index-based funds that obtained no-action relief from the CFTC.[13] In addition to regulation of USCF as a commodity pool operator by the CFTC and National Futures Association, the sale of Fund securities on the NYSE Arca subjects each Fund to comprehensive federal securities regulation by the SEC, FINRA and NYSE Arca. These regulatory organizations review the offering documents of each Fund and provide ongoing regulatory oversight of the Funds' operations.

> *vi. The futures trading does not result in price exposure for the fund.*[14]

As noted above, each Fund employs a "neutral" investment strategy intended to track changes in the price of a benchmark commodity future regardless of whether the price goes up or down. The fact that each Fund seeks only to track its benchmark commodity future and not to achieve any financial gain from its trading activities in futures markets means that the Funds do not experience the price exposure typically attendant to their futures trading. Instead, as with index-based funds, the Funds only experience price exposure with respect to their commitment to track their specified benchmark. The Funds best hedge this risk through their purchase of futures contracts that constitute or are closely related to their respective benchmarks. If stringent position limits were placed on their investments in the commodity futures contracts serving as benchmarks for the Funds, the Funds would be required to invest in investments that would not provide a direct correlation to price changes in the benchmark or may not provide the same level of credit risk that is provided by investments in exchange traded commodity futures.

IV. Conclusion

We appreciate the need for the CFTC to review its regulation of commodity futures activities in light of recent market events. However, we believe that the significant increase in energy prices last summer were wholly unrelated to the activities of our commodity-tracking funds using the commodity futures market to hedge the exposure to investors that results from their obligation to track the price movement of a commodity. In fact, the Funds play an important role in providing liquidity to the futures markets in a manner that is both transparent and contains less risk than alternative investments (*e.g.*, purchasing futures contracts directly on a leveraged basis, through a commodity trading advisor on a leveraged basis, or by entering into over-the-counter contracts). Our conclusions are based strictly on an examination of the data

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[12] *See* CFTC Letter 06-09 at 4.

[13] *See, e.g.*, CFTC Letter 06-09 at 3.

[14] *See* CFTC Letter 06-19 at 5.

comparing the Funds' buying and selling of futures versus the changes in price. However, since USO and UNG at all times during the period for which we reviewed the data constituted an overwhelming portion of assets and futures held by all crude oil or natural gas ETFs in the marketplace, we think it is reasonable to assume that, as a group, there is no evidence that crude oil ETFs or natural gas ETFs can possibly be the cause of the increases in crude oil prices in 2008 and 2009, or the increase in natural gas prices in 2008, or the drops in such prices.

It is difficult for the Funds' management to go further and make the claim that the activities of all of the commodity ETFs in the marketplace, including those in other single commodities aside from crude oil and natural gas or those that track diversified baskets consisting of many different commodity futures, have displayed a similar lack of price impact. Our data only pertains to crude oil and natural gas.[15] However, the universe of commodity ETFs aside from USO and UNG that own a noteworthy amount of commodity futures contracts is very small, about a dozen ETFs at most. Management believes that a review of the buying and selling patterns of these other commodity ETFs, and the coincident movement of commodity prices, should be a fairly simple task. However, if the large scale buying and selling of futures contracts by USO and UNG do not seem to be positively correlated with changes in crude oil and natural gas prices, but rather display a negative correlation, it raises the question of whether it is possible for large scale buying or selling by other commodity ETFs to have a positive correlation with commodity prices.

As previously noted, the Funds act solely as price takers—merely tracking the price movement of their respective commodities—and their respective investment strategies preclude them from acting in a way that could lead to the manipulation of prices or cornering of the futures market. Empirical data shows that the Funds' activities in the futures market have resulted in little or no price disruption even as the overall size of the Funds' positions have increased dramatically. Instead of disrupting the futures market, the Funds provide a steadying force by adding significant liquidity to the market. In fact, rather than acting as a source of risk, the Funds provide investors with a transparent, highly regulated, unleveraged vehicle through which to hedge their pre-existing price risk in commodities. Although the futures positions held by the Funds may appear to be large in relation to each Fund as the legal holder of such positions, these investments represent the aggregation of demand from tens of thousands of individual investors seeking to reduce their financial risk through hedging in the commodity futures market.

The CFTC staff has previously noted that passively managed index-tracking investment vehicles represent "a legitimate and potentially useful investment strategy"[16]. We agree with that view and that it should equally apply to investments in vehicles such as the Funds. We strongly encourage the CFTC to codify its staff's position and extend it to the Funds in any future regulation resulting from the CFTC's current regulatory review process.

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[15] We have not presented data on the markets for the other commodities tracked by USCF funds, *i.e.*, gasoline and heating oil, because the futures contract positions of the USCF funds in these markets are currently too small to raise any questions concerning their overall market impact.

[16] Concept Release, footnote 15.