Good morning Chairman Chambliss, Ranking Member Harkin, and Members of the Committee. I am a partner in the law firm of Morrison & Foerster LLP, and practice in the firm's Washington, D.C. office. I previously served as Associate General Counsel to the Board of Governors of the Federal Reserve System and, in that capacity, advised the Board on a wide range of matters relating to the Commodity Exchange Act ("Act"), and other issues regarding the regulation of derivative transactions. I am appearing before the Committee on behalf of the Huntsman Corporation ("Huntsman"), which is a member of the Industrial Energy Consumers of America. I thank you and the Members of the Committee for the opportunity to participate in today's hearing on the reauthorization of the Commodity Futures Trading Commission ("CFTC").

I would like to bring to the Committee's attention the important issues relating to the regulation of the natural gas futures contracts markets.

Huntsman is a global leader in the chemical manufacturing industry. Its operating companies manufacture basic products for a variety of global industries, including chemicals, plastics, automotive, agriculture, and others. Today, Huntsman employs over 11,000 men and women in 63 operations located in 22 countries. As this Committee is well aware, global manufacturing companies like Huntsman depend on the commodities markets for their materials and rely on fair pricing in those markets in order to be competitive both domestically and abroad. A key commodity for Huntsman, as well as thousands of other domestic businesses and millions of farmers and consumers, is natural gas.

In enacting the Commodity Futures Modernization Act of 2000 ("CFMA"), Congress amended the Act in significant ways. First, the regulation of contract markets was streamlined based on "core principles" designed to ensure fair and equitable trading for market participants across a variety of contracts. Second, the shadows of legal uncertainty that fell on much of the over-the-counter derivatives market were eliminated, enabling sophisticated market participants to appropriately negotiate and trade instruments that suit their needs. We would generally concur with CFTC Chair Brown-Hruska that the Act, as amended, "functions exceptionally well."

However, price volatility in the natural gas contracts markets since mid-2000 suggests that the market for natural gas futures contracts is not operating efficiently and, therefore ,that the regulatory framework that applies to natural gas should be reviewed.

To be clear, we recognize that the marketplace for natural gas is complex, and that prices are influenced by numerous supply and demand factors. In her testimony, CFTC Chair Brown-Hruska referred to the "recent run-ups in prices in natural gas" as one of the factors cited in calls to increase the CFTC's authority to generally regulate trading in the "energy sector." I will focus on the somewhat narrower issue of increased price volatility in the natural gas futures contracts markets. This development is appropriately within the domain of this Committee and the CFTC, and threatens to undermine the stability and confidence in the futures markets for natural gas.

The market for natural gas will operate most effectively when the price of natural gas is shaped by fundamental forces of supply and demand. This price will allocate supplies of gas within the economy most effectively, thereby benefiting producers, users of natural gas and the economy as a whole. Facilitating this pricing function is one of the key purposes of the Commodity Exchange Act. However, if this pricing process breaks down, that breakdown can result in inappropriate pricing and allocation of natural gas to the detriment of producers, users and the economy as a whole.

Price volatility, which can be generally defined as the movement between prices over a stated period of time, is an important characteristic of the commodities futures markets. Price volatility reflects necessary uncertainty about the changes in future prices. Although movements in futures contracts markets can be largely due to genuine uncertainty about supplies relative to expected demand, high levels of price volatility also may reflect trading activity that is unrelated to fundamentals of supply and demand and can impair the price discovery function of contract markets.

We believe that there is evidence that the level of price volatility in the futures market for natural gas is impairing, rather than promoting, pricing in the market for natural gas. Since the CFMA was enacted, day-to-day price volatility in the natural gas futures contracts traded on the New York Mercantile Exchange ("NYMEX") has increased substantially, even after taking into account the higher prices overall in the prices for natural gas during this period. By some measures, price volatility in the natural gas contracts traded on the NYMEX has increased by 60%. We note that during this same period, commercial-trading participants on the NYMEX, that is, participants who buy and sell natural gas for use in the real economy and trade in futures contracts to hedge their transactions in the cash markets, have declined to a relatively small percentage of the market participants.

We believe that the increased price volatility raises questions as to whether the trading in the natural gas contracts may be susceptible to deceptive or manipulative practices. We applaud the efforts that the CFTC has taken thus far to respond to recent unlawful acts in the markets for contracts involving natural gas. CFTC Chair Brown-Hruska correctly observed that the CFTC has acted resolutely in these markets and that its authority to prosecute those who commit fraudulent or manipulative acts is significant. However, we believe that the Committee should consider additional measures to augment the authority of the CFTC to address issues related to natural gas contracts, including the potential for manipulation.

In particular, we believe that the Committee should consider implementing four basic changes to the Act, each of which would facilitate greater transparency in trading and, thereby, promote more efficient pricing based on open and fair competition.

Treat Natural Gas as an Agricultural Commodity

First, the Committee should consider amending the Act so that trading that involves natural gas is regulated under the same rules that apply to agricultural commodities. As Dr. James Newsome, President of the NYMEX, correctly noted, Congress has provided in the Act, as amended, "various market tiers" so that a marketplace can select its appropriate level of regulation according to the product type offered. We believe that the cash market for natural gas more closely resembles the cash market for agricultural commodities than the markets for financial instruments.

CFTC Review of Natural Gas Contracts

Second, the Committee should consider requiring the CFTC to review and seek public comment on existing rules for natural gas contracts and determine whether each rule that currently applies to natural gas is consistent with the "core principles" established in the Act. We believe that, going forward, the CFTC also should apply this process to future changes to rules for contracts involving natural gas, as proposed by the relevant contract market. This greater scrutiny of rules regarding natural gas contracts would help to ensure their consistency with the core principles.

For example, we believe that the current rules in place on the NYMEX relating to the maximum limits on the daily price fluctuation, sometimes known as "circuit breakers," for trading in natural gas contracts impose no practical limits. While we recognize that circuit breakers are a controversial issue, we believe that circuit breakers can provide important time for markets to evaluate new information and to act appropriately, therefore promoting the price discovery function. We believe that a circuit breaker in excess of eight (8) percent, in either direction, should be reviewed particularly carefully for consistency with the core principles. This threshold would be similar to the circuit breakers that were in place on the NYMEX in early-year 2000 before price volatility began to increase.

Large Position Reports

Third, the Committee should consider amending the Act to give the CFTC back-up authority to require any person holding large positions in natural gas contracts either on contract markets, or in the over-the-counter markets, or large quantities of natural gas, to file reports regarding those positions or quantities. Any holding or position that otherwise is required to be reported to any U.S. government agency should be exempt if that report would be made available to the CFTC upon request. The CFTC also should be authorized, but not required, to prescribe recordkeeping requirements as appropriate to determine that persons subject to the requirements to file reports are complying with such reporting requirements.
The CFTC would be expected to use these authorities sparingly, taking into consideration the burden that they may impose, as well as their utility in detecting or deterring manipulations.

Cash Settlement of Natural Gas Contracts

Fourth, the Committee should consider amendments to the Act that provide additional authority for the CFTC to prescribe rules for cash settlement of natural gas contracts, instead of physical delivery, to combat manipulation in prices of those contracts. Appropriate rules for cash settlement could help to deter and even break short squeezes on contract markets. These rules would apply only to circumstances where market conditions suggest the possibility of manipulation.

Thank you for the opportunity to be here today. I would be happy to address any comments that the Committee may have.