Fact Sheet: Stop Speculators From Driving Gas Prices Higher and Ruining Summer Vacations

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> *"We can't afford a situation where speculators artificially manipulate markets by buying up oil, creating the perception of a shortage and driving prices higher, only to flip the oil for a quick profit. We can't afford a situation where some speculators can reap millions, while millions of American families get the short end of the stick."*[1]
>
> \- President Barack Obama

As Memorial Day approaches, many Americans are excited to kick off the summer driving season and take in new sights and experiences with their loved ones. Unfortunately, an unwelcome passenger on that trip could be needlessly high gas prices picking the pockets of American consumers. While there are several factors that contribute to the rise in gas prices, oil companies profiteering and commodity speculators appear to be significant contributing factors and regulators and policymakers need to act to ensure that the public interest is protected.

Prices for commodities like gas and oil are supposed to reflect their fundamental value based on supply and demand. Those prices should be based on the purchases and sales by actual commodity producers and purchasers like oil companies on the one hand and gas station owners on the other (resulting in what is called "price discovery"). However, there usually are not enough of those physical producers and purchasers (sometimes called "end users") at all times to always satisfy the supply or demand. That is why financial speculators are allowed a very limited role in the commodity markets: to fill the gaps when physical producers and purchasers are not readily available to buy or sell.

Thus, speculation is a legitimate and necessary part of the commodities markets because it can provide liquidity and help to facilitate price discovery. But permissible speculation must be limited, or it will overtake and undermine these markets, defeating the very purpose of the markets. That is why excessive speculation is explicitly prohibited by law. Excessive speculation in commodity markets occurs when speculators disproportionately influence the prices of commodities beyond their fundamental value. That can occur due to high volumes of trades and large positions involving traders or investors engaging in speculative betting, such as buying and selling oil futures contracts, with the primary goal of profiting from short-term price movements rather than actual consumption or production of the underlying commodity.

Excessive speculation in the oil and gas commodity markets hurt Main Street families who rely on these essential resources. That's because speculative betting often contributes to price volatility and has a strong impact on prices which drives up the price of oil and, subsequently, the price of gas. Price volatility in the oil and gas markets makes it hard for families to plan and manage their expenses. Unpredictable fuel prices directly impact the affordability of driving to work, driving kids to after-school activities, and driving to vacation destinations.

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[1] Remarks by the President on Increasing Oversight on Manipulation in Oil Markets (April 17, 2012) https://obamawhitehouse.archives.gov/the-press-office/2012/04/17/remarks-president-increasing-oversight-manipulation-oil-markets

This volatility disrupts budgeting and makes it challenging for families to allocate their resources effectively.

Higher oil and gas prices also have wider economic implications. Businesses, especially those heavily reliant on transportation or energy-intensive operations, face increased costs. To compensate for these expenses, businesses often pass them on to consumers through higher prices for goods and services. This economic chain reaction further strains the financial budgets of American families, making it even more challenging for them to meet their basic needs and maintain a reasonable standard of living.

Fortunately, Congress mandated the Commodity Futures Trading Commission ("CFTC" or "Commission") to establish and enforce regulations to define and restrict the volume of trading and positions held by speculators.[2] These measures are designed to reduce, eliminate, or prevent undue burdens within the market.[3] The Commission was also mandated to reduce, eliminate, or prevent excessive speculation in the commodities markets.[4]

Limiting the trading positions of speculators (called "position limits") can serve as a vital tool for the CFTC in its efforts to address price volatility and uphold the functionality of energy derivatives markets for the benefit of commercial producers and consumers. The aim is to ensure that embarking on a drive to the beach doesn't become an excessively costly endeavor for families. However, the CFTC's most recent rulemaking on position limits falls short of achieving the necessary equilibrium between the interests of producers and consumers, who are the primary focus of derivatives markets, and the role of speculators, high rollers that should remain confined within defined boundaries.[5]

Adjusting Federal Position Limits: Ensuring a Fair Game

Similar to a dealer at a casino when there is evidence of cheating, the CFTC should reshuffle and adjust its current position limits regulation if there is any evidence that the federal position limits are set too high in the energy commodities markets. Given the recent historic profits of the biggest energy commodities players, the CFTC has circumstantial evidence to conduct a thorough investigation into whether excessive speculations in the energy commodities markets were the driving force behind these profits.

For example, in 2022 when many Americans faced soaring gas prices, Exxon Mobil and Chevron recorded record-breaking combined profits of over $90 billion last year.[6] In fact, five of the West's largest energy companies have reported nearly $200 billion in 2022 profits combined.[7] Vitol, the world's largest independent oil trading

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2 7 U.S.C. § 6a(a)(1).

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4 *Id*.

5 *See generally* Better Markets, Comment Letter: Position Limits for Derivatives (RIN 3038AD99) (May 15, 2020),(https://bettermarkets.org/newsroom/cftc-s-long-overdue-position-limits-rule-will-not-stop-excessive-speculation-will-raise/)

6 Clifford Krauss, The New York Times (February 1, 2023), "What Exxon and Chevron Are Doing With Those Big Profits," *available at* https://www.nytimes.com/2023/02/01/business/energy-environment/exxon-chevron-oil-gas-profit.html.

7 Wyatte Grantham-Philips, USA Today (February 10, 2023), "'Outrageous': Big oil made almost $200 billion in 2022 as world faced energy crisis. Here's the breakdown," available at https://www.usatoday.com/story/money/at-home/2023/02/10/oil-companies-2022-profits-exxon-bp-shell/11170023002/.

company, matched its combined earnings from the prior six years with profits of almost $15 billion.[8] Vitol's profits surpassed those of some of the world's largest oil producers, highlighting how traders have capitalized on the immense volatility in energy markets sparked by Russia's invasion of Ukraine.[9] Energy Traders Gunvor, Trafigura Group, and Mercuria Energy Group have recorded record-breaking profits by also taking advantage of arbitrage opportunities amidst a significant spike in prices for various goods, reaching unprecedented levels.[10]

While genuine supply and demand issues, including Russia's war on Ukraine, may explain some volatility in the energy commodities markets. Excess speculation not being reined in by effective position limits exacerbated the volatility in these markets which likely caused speculators to receive historic, outsized profits. Because the applicable position limits rule adopted by the CFTC in October of 2020 was deficient and riddled with loopholes (as cogently detailed in the dissents of then-Commissioners Russ Behnam and Dan Berkovitz[11]), greater speculation was the inevitable result.

While little can be done by the CFTC about the supply/demand factors and shocks that are impacting gas prices, one thing that the CFTC can and should do is conduct an investigation into what role, if any, excess financial speculation has played in the energy commodities markets. The investigation should be done regardless of price increases, declines, or volatility, or additional supply/demand shocks over the next several weeks and months, which are inevitable.[12] Whether oil goes to a "worst case" $380 a barrel or "collapses to $65" or whether there's a recession that destroys demand, drives down inflation and commodity prices,[13] the CFTC's legal duty to eliminate "excess speculation" remains and it has established position limits ostensibly designed to accomplish that goal.

Excessive speculation in energy commodity markets disrupts the crucial functions of price discovery and hedging, making it challenging to determine accurate pricing and resulting in prohibitively high hedging costs. Southwest Airlines serves as a notable example of the significance of these functions for companies and, ultimately, consumers. The airline successfully employed hedging strategies for its oil purchases, allowing it to maintain affordable prices and generate substantial profits despite the escalation and volatility of fuel prices. However, other airlines refrain from hedging strategies because they see hedging as "a Wall Street rip off." [14] This implies

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8 Leslie Hook, David Sheppard, Financial Times (March 20, 2023), "Vitol profits soar to record $15bn on back of energy crisis," available at https://www.ft.com/content/efdabd7f-949e-4016-a099-c13c99960ed0

9 *Id*.

10 Archie Hunter, Bloomberg (April 5, 2023), "Energy Trader Gunvor Made Record $2.4 Billion Profit in 2022," available at https://www.bloomberg.com/news/articles/2023-04-05/commodity-trader-gunvor-made-record-2-4-billion-profits-in-2022?sref=mQvUqJZj

11 *See* Oct. 15, 2020 dissents of CFTC Commissioners Dan Berkovitz here and (now Chair) Russ Behnam here.

12 *See, e.g.,* Harry Dempsey, et al., The Financial Times (July 5, 2022), "Norway strikes threaten to cut off gas supplies to UK within days," *available at* https://www.ft.com/content/bd5a3c33-03bc-4434-8465-9d306b8885da?emailId=62c41815bdcb1a0023a6f9b2&segmentId=3d08be62-315f-7330-5bbd-af33dc531acb.

13 Ryan Dezember, Wall Street Journal (July 4, 2022), "Falling Commodity Prices Raise Hopes that Inflation Has Peaked: Oil, wheat, natural gas, lumber, corn and other raw materials ended tumultuous quarter near or lower than March prices," *available at* https://www.wsj.com/articles/falling-commodity-prices-raise-hopes-that-inflation-has-peaked-11656811949.

14 Steff Chavez, The Financial Times (June 27, 2022), "'We will humble them': four fuel traders took on Wall Street and saved $1.2bn," *available at* https://www.ft.com/content/0d5c60fd-ccba-4c69-bbfd-0b7591651771.

that financial speculators are exploiting physical purchasers.

This example illustrates how potentially excessive speculation can defeat the very important social purposes for the energy commodities markets to exist in the first place. They are not supposed to be gambling dens for financial players to speculate to maximize their profits and bonuses. They are supposed to exist to facilitate the delivery of essential commodities to the American people at a market price determined largely by supply and demand fundamentals through the interaction of actual physical producers and purchasers.

That is why, unlike equity markets, speculation is only allowed to the degree it serves the public purposes of the commodities markets, which include assisting actual physical producers and purchasers in determining present and future prices for their products and enabling them to hedge against price risks. The objective is to limit the influence of speculation in these markets and ensure that they effectively serve the needs of actual producers and purchasers. By doing so, these commodities markets remain anchored to real supply-demand dynamics and fundamental pricing. Any speculation that exceeds the limited role and necessary level to fulfill these objectives is excessive and prohibited.

The CFTC should conduct an investigation and gather and analyze the facts and data, write a comprehensive report, and make all the information available to the public. [15] By doing so, the American people can have trust in the investigation, report, and resulting conclusions. Properly conducted, the data will make clear the level of speculation, and the facts will provide a basis for determining whether it is excessive or not. However, if the data provide evidence of excessive speculations, then the CFTC is obligated under the statute to take appropriate action, including revising its position limits rulemaking if warranted.

Conclusion

Summer driving season holds a special place in the hearts of Americans; however, numerous families may face the obstacle of rising fuel prices, leading to heightened expenses for their road trips and vacations. One of the reasons for this price surge appears to be excessive speculation in the energy commodities markets. Such speculation leads to unpredictable price fluctuations, making it challenging for families to plan their finances effectively and allocate their resources appropriately. To address these key kitchen table pressures, the CFTC needs to investigate the energy commodities markets to determine whether such speculation is causing undue volatility which is playing a role in the historic profits being made by the biggest energy commodities players.

The CFTC's legal duty to eliminate "excess speculation" remains, and it has established position limits to accomplish that goal. The investigation should be done regardless of price increases, declines, or volatility, or additional supply/demand shocks over the next several weeks and months, which are inevitable. By analyzing the data and facts, the CFTC can determine whether the current position limits are set too high and can make necessary adjustments to ensure that these commodities markets effectively serve the needs of actual producers and purchasers. Taking such action will convey a powerful message to both Americans and the global

[15] It is important that the investigation is done without preconditions or prejudging the outcome. This would be in stark contrast to the CFTC staff's November 23, 2020 "Interim Report on NYMEX WTI Crude Contract Trading on and around April 20, 2020," which supported the former Chairman Tarbert's precipitous and apparently baseless statement on CNBC that the historic and unprecedented WTI price swing was due to supply and demand. *See* CNBC (April 21, 2020), "CFTC Chair Heath Tarbert on oil futures' plummet," *available at* https://www.cnbc.com/video/2020/04/21/commodity-futures-trading-commission-chair-heath-tarbert-on-oil-futures-plummet.html

community that the energy commodities markets are functioning effectively, efficiently, and as intended by Congress to serve their critically important social purpose.

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