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April 26, 2010

REVISED

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

Re: Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations

Dear Mr. Stawick:

This letter is submitted on behalf of Vitol Inc. ("Vitol") in response to the proposed rule issued by the Commodity Futures Trading Commission (the "CFTC" or the "Commission") regarding whether the CFTC should directly impose speculative position limits on futures and option contracts in four energy commodities and whether to create a limited risk management exemption, administered by the CFTC for swap dealers holding positions outside the spot month (the "Proposed Rule").

Vitol is part of the Vitol Group of companies, one of the world's largest independent energy trading organizations. The Vitol Group extracts, trades, stores and transports energy commodities around the globe, helping to bring those commodities to the places where supply/demand factors dictate they are needed.

I. Introduction

We are pleased to share our comments with the Commission on the Proposed Rule to the extent that it relates to the commercial trading activities of Vitol. While we raise issues of particular concern to Vitol in this comment letter, we also support the concerns addressed in the comment letters submitted to the Commission by the Futures Industry Association and the International Swaps and Derivatives Association, Inc., particularly with respect to the proposed "crowding out" of speculative trading activity, the elimination of the independent account controller exemption, the arbitrary cap on risk management exemptions, and the significant operational burden of the Proposed Rule on market participants.

II. Restrictions on Speculative Activity

A. "Crowding Out"

Our concerns about the "crowding out" provisions of the Proposed Rule are very straightforward. As a large commercial market participant, Vitol may well need to avail itself of an exemption from the speculative position limits for bona fide hedging transactions. Under the Proposed Rule, if it held positions at the level of the position limit it would be prohibited from maintaining a single speculative position. This is a significant change to current market practice.

Currently, a market participant may hold a combination of hedge and speculative positions pursuant to a hedge exemption, provided that the speculative component did not exceed the speculative position limit. The Commission has not explained its rationale, and we can see no basis, for abandoning that paradigm. We are aware of no study (nor even prior assertions) that suggests that "concentration" has been an issue in the markets – namely, that a party that has a large position that is part speculative and part bona fide hedge poses a greater threat to market stability than a party with a position of the same size containing exclusively bona fide hedge positions. We do not believe that to be the case. In fact, to the contrary, it has been well established that futures markets require speculative activity to absorb risk that commercials are unwilling to bear and to even out the temporary imbalances between supply and demand (i.e. provide liquidity). We would submit that speculation by commercial market participants, properly managed, best serves that purpose, as a commercial speculator could choose to make or take delivery on a speculative position rather than liquidate it in a distressed market -- conduct which would add to, rather than detract from, market stability.

Under the "crowding out" provisions of the Proposed Rule, three traders with similarly-sized total positions would apparently pose a different threat to the market. Assume an all months speculative limit of 50,000 contracts; that Traders A and B have hedge exemptions that allow them to hold 55,000 contracts; and that Trader C has no hedge exemption. Trader A is short 49,000 hedges and 4,000 speculative positions; Trader B is long 4,000 hedges and 45,000 speculative positions; and Trader C is long 49,000 speculative positions. Trader A, the party with the least speculative position, would be prohibited from hedging an additional cargo of petroleum products at the level of 2,000 contracts unless, at its cost and risk, it exits the speculative position it carried. We do not see how, in the name of "preventing excessive speculation", Trader A's position of 51,000 hedges and 4,000 speculative positions, could be deemed to present a greater risk of "causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity" than the substantially greater speculative positions of Traders B and C. We also do not see the material difference in risk of Trader A's position were it to be comprised as above, or if all 55,000 positions were hedges. Yet the Proposed Rule, without any empirical basis to support the "concentration" concerns, would require Trader A to engage in the cost and risk of a "forced liquidation" of its speculative position if the additional commercial opportunity arose.

Another significant issue with the Proposed Rule is regulatory and enforcement risk. A commercial market participant often holds a large, complex, diversified and dynamic portfolio of market positions, including futures and exchange traded options on more than one exchange, cleared and over-the-counter swaps and options, inventory and executory physical delivery contracts. The position of a firm in the energy markets is a composite of the positions of multiple product managers – divided regionally and among crude oil and the many grades of petroleum products. Vitol submits that determining when such a portfolio is precisely balanced or hedged, and contains no speculative positions, is so far to the extreme of virtually impossible that is may be more appropriate to say that it simply is not possible. In many respects, the conclusion "is in the eye of the beholder". Would this subject a market participant to second-guessing of, for example, its volatility assumptions and, therefore, the risk to be hedged over the forward curve of its position? The Proposed Rule does not, and probably can not, adequately address the issues associated with determining whether there is a speculative component in any dynamic, portfolio hedged position.

Timing issues are also significant in that respect. Take the case of a commercial market participant with a hedge exemption that is using the exemption to hedge inventory positions in excess of the speculative position limit. An opportunity arises to sell some of the inventory and it does so. It then seeks to lift its hedge. Must it place an immediate order to liquidate the entire hedge position, or may it "work" its order to ensure that it does not create short-term market disequilibrium, resulting in a market impact and worse prices for its own transactions? Does holding the positions while the order is "worked" constitute speculating? If not immediately, how long does one have to work an order, an hour, a day, more than a day if the product/instrument/delivery month is less liquid? Is it a subjective test? If so, that would put a commercial market participant in a world of uncertain regulatory exposure. Again, the Proposed Rule does not, and probably can not, adequately address that issue.

The Proposed Rule probably imposes a bias to "under-hedge" rather than risk holding an "over-hedged" position. An "under-hedge" in this regulatory construct would constitute "speculating" in the physical market, with no regulatory ramification. By contrast, an "over-hedged" position would constitute "speculating" in futures or options, in violation of the Proposed Rule for a party operating under a hedge exemption. Clearly, driving parties to take physical market risk to avoid regulatory exposure would not be a good policy outcome.

Finally, the "crowding out" provisions create practical problems when coupled with other provisions in the Proposed Rule. For example, Vitol may be in a position to obtain and use an exemption for bona fide hedging. Under the rules as they exist today, it could hold a risk-free position in an OTC swap against a listed futures contract. Under the Proposed Rule, that position would not qualify as a bona fide hedge. While it may qualify as a "risk management" position under the Proposed Rule, that position would also be "crowded out" and Vitol would be required to liquidate it. Ironically, this would force us to take risk in the name of reducing the risk of "speculative" activity. We do not believe that is an intended consequence of the Proposed Rule or good policy.

B. Elimination of the Independent Account Controller Exemption

The Proposed Rule would require aggregation of the positions in accounts in which any person has an ownership or equity interest of 10% or more, or with respect to which such person controls the trading, in determining compliance with the position limits. We would urge the Commission to consider an exemption from the aggregation requirements for any accounts that are commonly owned, but separately controlled. There is a perverse result in the Proposed Rule that would actually require communication and coordination among account controllers that are otherwise independent, creating the risk of intended or inadvertent common patterns of trading that would otherwise not exist. Any two accounts, whether managed by CTAs or part of a corporate family should not be aggregated if common control is not present.

The problem with the Proposed Rule is compounded by the imposition of the "crowding out" restrictions across affiliates and independent business units where common control did not exist. Under the proposal, if one affiliate or business unit of a market participant were trading in a manner that does not qualify for a hedge exemption, the other independent business units would be forced to reduce their positions so that all the units were below the position limit, even if the other units had received bona fide hedge exemptions. Thus, the speculative trading activity of one entity will preclude the other units from trading in the market above the aggregated position limit. We believe the elimination of the independent account controller exemption, in combination with the "crowding out" provision, will significantly reduce the liquidity in the futures market, with no discernable benefit to market participants. Commercial hedgers such as Vitol will be particularly harmed. As the Commission is well aware, reduced liquidity harms consumers, as well, as it often results in greater market volatility, reduced ability to absorb short-term supply/demand imbalances and higher prices.

III. Calculation and Structure of Position Limits

Under the Proposed Rule, the CFTC would impose position limits on an annual basis, based on the open interest in the relevant contract. We believe that for Vitol to comply with these position limits, we will need a thorough understanding of the way the CFTC will calculate the open interest for the four energy commodities. We note that following the release of the Proposed Rule, there has been considerable confusion as to how the CFTC derived the open interest used to generate the potential position limits cited in the Proposed Rule. If the CFTC does implement the Proposed Rule, we strongly urge the CFTC to provide all market participants with the information they will need to calculate the position limits in a timely manner, in order to prevent any disruptions to the market. We believe that the data used by the CFTC to calculate the position limits will need to be completely transparent in order to enable market participants to protect against any emergency liquidation of positions that may be necessary to comply with the position limits.

We also believe that there is a structural flaw in the Proposed Rule. As market participants are likely to stay below the position limits, open interest will decrease. This will, by definition, lead to lower position limits the following year and create a cycle of lower open interest and lower position limits every year.

IV. Treatment of Arbitrage and Spread Trades

Market participants employ a wide variety of trading strategies to precisely manage their risks, including arbitrage and spread trades. These trading strategies have been recognized by exchanges, such as NYMEX, as a valid basis for granting an exemption from speculative position limits. The Proposed Rule does not appear to address these hedging strategies, and we strongly urge the CFTC to do so.

V. Definition of "Gross Basis"

Section 151.2(b)(2)(ii) of the Proposed Rule, a market participant's positions in contracts of the same class in a single month, measured on a "gross basis," could be no larger than two times the all-months-combined class position limit fixed for that reporting market. However, the Proposed Rule does not define "gross basis" and it is unclear how the CFTC would define and then measure "class" positions, which may actually involve more than one futures and or options contract, on a "gross basis." Would each "contract" rather than the "class" be measured on a "gross basis"? To prevent any confusion by market participants, we urge the CFTC to clarify how positions would be measured on a "gross basis."

VI. Conclusion

Vitol appreciates the opportunity to provide the Commission with its comments on the Proposed Rule. We would be pleased to discuss the issues raised in our letter in greater detail, at your convenience.

Respectfully submitted,

Miguel A. Loya
President

cc: Chairman Gary Gensler
Commissioner Bart Chilton
Commissioner Michael Dunn
Commissioner Scott D. O'Malia
Commissioner Jill E. Sommers