



October 28, 2010

BY ELECTRONIC SUBMISSION

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 20581

**Re: Agricultural Swaps ANPRM;
Agricultural Commodity Definition (RIN 3038-AD21)**

Dear Mr. Stawick:

The Gavilon Group, LLC (“Gavilon”) appreciates the opportunity to submit its comments in response to the Commodity Futures Trading Commission’s (“Commission” or “CFTC”) September 28, 2010, Advance Notice of Proposed Rulemaking and Request for Comment¹ (the “Advance Notice”) regarding the treatment of swaps in an “agricultural commodity,” as well as the CFTC’s Notice of Proposed Rulemaking regarding the definition of “agricultural commodity”² (the “Proposed Rule”) under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).³ Gavilon respectfully requests that the Commission promulgate rules that will reduce risk and increase transparency within agricultural markets without limiting access to these important markets by farmers, cooperatives, food manufacturers, agribusinesses and others who need to mitigate the risks associated with their businesses.

I. DESCRIPTION OF GAVILON AND ITS INTEREST IN THE PROPOSED RULE

Gavilon’s agricultural operations serve farmers, livestock producers, the commercial food industry, dairy producers, feed manufacturers and industrial users. Gavilon provides origination and distribution, physical merchandising, storage, transportation, and logistics services for a variety of agricultural and fertilizer products, including: (i) corn products, such as distillers dried grains with solubles, wet distillers grain, hominy, gluten feed and corn oil; (ii) wheat products such as wheat midds, midd pellets, red dog, wheat bran, wheat germ and second clear flour; (iii) animal products such as beef meal, pork meal, bone meal, blood meal, feather meal, edible and inedible tallow, edible lard, choice white grease and yellow grease; (iv) oilseed

¹ Agricultural Swaps, 75 Fed. Reg. 59666 (Sept. 28, 2010).

² Agricultural Commodity Definition, 75 Fed. Reg. 65586 (Oct. 26, 2010).

³ Pub. L. No. 111-203 (2010) (to be codified as an amendment to the Commodity Exchange Act in 7 U.S.C. ch. 1. (the “Commodity Exchange Act” (“CEA”)) (“Dodd-Frank Act”).

products such as whole cottonseed, cottonseed meal, cottonseed hulls, canola meal, soy meal and soy hulls; (v) oil products such as cottonseed oil, corn oil, palm oil, canola oil and soybean oil; and (vi) dairy products. Gavilon also operates a large fertilizer distribution network and provides wholesalers with a wide array of bulk fertilizer products including nitrogen-based, phosphate-based and potash-based fertilizers.

Gavilon has an important interest in how the Commission defines “agricultural commodity” and what conditions, restrictions, or protections it places on the trading of agricultural commodity swaps. The CFTC’s rules governing agricultural swaps will have a significant impact on the risk management alternatives available to Gavilon and its counterparties and, thus, their ability to provide a reliable supply of competitively priced agricultural products to consumers throughout the country.

II. SUMMARY OF COMMENTS

Gavilon requests that any rule governing agricultural swaps proposed by the Commission allow for swaps and options on agricultural commodities to the same extent as other commodity swaps are permitted under the Dodd-Frank Act. Specifically, Gavilon urges the Commission to allow an entity who qualifies as a swap dealer or major swap participant for one type, class, or category of agricultural commodity not to be considered as a swap dealer or major swap participant for other types, classes, or categories of agricultural commodities. These entities should remain eligible for the end-user exemption with respect to commodities for which they are end-users hedging commercial risk. Gavilon also requests that the Commission consider adopting a rule for agricultural swaps that treats swaps, swaptions, and options the same. Gavilon supports the Commission’s proposed definition of “agricultural swap”, but suggests one modification: the Commission should clarify that the second category of the definition encompasses agricultural commodities that are not currently, but which may in the future be the subject of derivatives trading, without the need for additional CFTC action.

III. PROPOSED FRAMEWORK FOR AGRICULTURAL SWAP EXEMPTIONS

A. The Commission Should Adopt its Proposed Definition of Agricultural Commodity

On October 26, 2010, the CFTC issued a proposed definition of “agricultural commodity,” which divides agricultural commodities into four categories:

- the enumerated commodities listed in CEA §1a;
- all other commodities that are, or once were, or are derived from, living organisms, including plant, animal and aquatic life, which are generally fungible, within their respective classes, and are used primarily for human food, shelter, animal feed, or natural fiber;

- tobacco, products of horticulture, and such other commodities used or consumed by animals or humans as the Commission may by rule, regulation or order designate after notice and opportunity for hearing; and
- commodity-based contracts based wholly or principally on a single underlying agricultural commodity.⁴

Gavilon generally supports the Commission's proposed definition. In particular, Gavilon supports the Commission's exclusion of fertilizer, denatured ethanol, and plant or animal based renewable fuels, such as methane or biodiesel, from the definition of agricultural commodity.⁵ These types of commodities more appropriately should be treated as exempt commodities. However, the Commission should clarify that the second prong of the definition encompasses agricultural commodities that are not currently, but which may in the future be the subject of derivatives trading without the need for additional CFTC action. This is consistent with Congress' definition of "commodity" in the CEA, which includes certain enumerated commodities and "all other goods and articles, . . . and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in."⁶ The Commission should expressly state that the definition includes not only those agricultural commodities that currently are the subject of derivatives trading, but also those that may form the basis of a derivatives contract in the future. This will promote legal certainty by clarifying that all transactions involving different types of agricultural commodities are subject to the same regulatory framework.

⁴ Proposed Rule, 75 Fed. Reg. at 65593.

⁵ The Commission clarified that the definition of "agricultural commodity" "would not include denatured ethanol, which is used for fuel and for other industrial uses, because denatured ethanol cannot be used for human food. Likewise, neither would Category 2 include other plant or animal based renewable fuels, such as methane or biodiesel. Fertilizer and other agricultural chemicals, even though they are used almost exclusively in agriculture, would not fall within the definition because they would not fit into the food, shelter, animal feed or natural fiber category." *Id.* at 65590.

⁶ 7 U.S.C. § 1a(4); *see, e.g., Statement of the Commission* (June 14, 2010), available at <http://www.cftc.gov/ucm/groups/public/@otherif/documents/ifdocs/mdexcommissionstatement061410.pdf> (CFTC has jurisdiction over all commodities "which are or may be the subject of futures contracts"); *see also* Concept Release on the Appropriate Regulatory Treatment of Event Contracts, 73 Fed. Reg. 25669, 25671 (May 7, 2008) ("[A]n underlying interest that is not enumerated in [the definition of a commodity] may be a statutory commodity under the Act if it reasonably can underlie a futures contract on a forward looking basis.").

B. The Commission Should Allow An Entity To Be Designated as a Swap Dealer or Major Swap Participant for a Single Type, Class or Category of Agricultural Commodity And Not For Others

The Dodd-Frank Act provides that “[a] person may be designated as a swap dealer for a single type or single class or category of swap or activities and considered not to be a swap dealer for other types, classes, or categories of swaps or activities.”⁷ This also should be the case for agricultural commodities. As discussed below, treating agricultural swaps on an equivalent basis with other commodity swaps is in the public interest given the increased oversight of all swaps under the Dodd-Frank Act.

It is very important that entities that enter into swaps as a swap dealer (“SD”) or major swap participant (“MSP”) with respect to one agricultural commodity be able to qualify for an end-user exemption with respect to commodities for which they are end-users hedging commercial risk. Congress recognized that requiring end-users to clear all of their swaps would have a significant, adverse effect on these businesses (and their customers), while doing little to reduce financial instability or systemic risk.⁸

C. The Commission Should Regulate Agricultural Swaps Consistently With Other Commodity Swaps

Given the increased oversight of all swaps under the Dodd-Frank Act, the Commission should treat agricultural swaps the same as other commodity swaps.⁹ The Commission specifically should consider applying many of the same requirements to SDs and MSPs that qualify as such based on their agricultural swaps transactions, including capital and margin requirements and business conduct standards (except with respect to end-user transactions that hedge commercial risk). As with other commodity swaps, the Commission should require that agricultural swaps be: (1) cleared to the extent they are accepted for clearing by a designated clearing organization (“DCO”) (except for end-user swap transactions used to hedge commercial

⁷ Dodd-Frank Act § 721(a)(21) (to be codified at CEA §1a(49)).

⁸ Representative Michael McMahon explained: “This legislation also recognizes the important role that derivatives play in actually reducing systemic risk for our end user companies and in increasing the flow of credit throughout our economy. Whether it is an airplane or farm machinery manufacturer hedging against currency risks, a commercial real estate company or life insurance annuity hedging against interest rate fluctuation, or an energy provider trying to hedge the price of oil and gas, derivatives are vital tools to keep consumer prices low and to help manage company budgets. *These end-user companies pose little or no systemic risk to our economy, and this bill protects them from unnecessary and burdensome margin and clearing requirements.*” 156 Cong. Rec. H5230 (daily ed. June 30, 2010) (statement of Rep. McMahon) (emphasis added).

⁹ The Commission should interpret the statutory exclusion from the definition of swap consistently with long-established precedent regarding the forward contract exclusion in the definition of future delivery (including with respect to the treatment of bookouts).

risk and pre-existing swaps); and (2) reported to the extent they are not cleared. Finally, the Commission should permit uncleared over-the-counter (“OTC”) agricultural swaps to be traded by “appropriate persons,” which should be defined as eligible contract participants (“ECPs”). This will promote legal certainty and avoid creating multiple categories of appropriate persons.

The Commission should not impose restrictions on OTC agricultural swaps that are additional to those applied to other commodity swaps because all swaps will be subject to increased oversight under the enhanced regulatory framework provided by the Dodd-Frank Act. Moreover, agricultural swaps markets currently function well and have not contributed to the financial crisis in the United States. Therefore, there is no reason to treat agricultural commodities more stringently. For example, the end-user exception from clearing provided in the Dodd-Frank Act is just as important for agricultural end-users as it is for end-users of other commodities.¹⁰ It is very important that the Commission provide a broad end-user exception from mandatory clearing of agricultural swaps. If end-users were required to clear agricultural swaps, they would incur higher margin costs, which would reduce the cost-benefits they could achieve through hedging and take limited capital away from farming, marketing and processing operations. This also likely would increase costs for consumers.

Similarly, just as the Commission will make case-by-case determinations as to whether an individual commodity swap is appropriate for clearing, it should carefully review each agricultural swap. Those swaps that cannot be cleared should be permitted to be traded OTC between ECPs on an equivalent basis as other commodity swaps.

Allowing agricultural swaps to be executed on the same basis as other commodity swaps is in the public interest because it would increase regulatory certainty in commodity markets by allowing market participants to structure documentation and compliance protocols consistently across commodity desks. Applying many aspects of the Dodd-Frank Act to agricultural swaps on an equivalent basis as other commodity swaps (*e.g.*, clearing and reporting as discussed above) also would promote the Commission’s stated mission of bringing more transparency to the OTC derivatives markets.¹¹

¹⁰ See *supra* note 8.

¹¹ Section 4(c)(2) of the CEA requires the CFTC to adopt a rule that is in the public interest and that does not give rise to contracts, agreements, or transactions that materially adversely affect the Commission’s or any designated contract market’s regulatory or self-regulatory duties under the CEA. Treating agricultural swaps consistently with other commodity swaps meets section 4(c)(2)’s requirements because Title VII of the Dodd-Frank Act introduces a regulatory regime that provides increased regulation of all swaps and eliminates the need to impose additional conditions on agricultural swaps.

D. The Commission Should Adopt an Exemption for Agricultural Swaps that Regulates Swaps and Options the Same Manner

The Commission should consider adopting a rule for agricultural swaps that treats swaps, swaptions, and options the same. Congress indicated its intent to treat these products the same by including a definition of “swap” that specifically includes swaptions and options:

[T]he term “swap” means any agreement, contract, or transaction that is a put, call, cap, floor collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind; . . . [or] an agreement, contract, or transaction that is, or in the future becomes, commonly known to the trade as a swap . . . [or] that is any combination or permutation of, or option on, any [swap].¹²

Although options based on the enumerated agricultural commodities historically have been subject to more stringent regulation than swaps under the CEA, options on non-enumerated agricultural options have been treated on an equivalent basis with swaps. As the Commission stated in its Proposed Rule regarding the definition of “agricultural commodity”:

Because the term “agricultural commodity” in the Act refers to more than just the enumerated commodities, the Commission recognizes that certain options authorized under § 32.4 (*e.g.* off-exchange options on coffee, sugar, cocoa, and other agricultural products that do not appear in the enumerated commodity list) will be considered to be swaps in an agricultural commodity—and subject to any Commission rules that specifically address agricultural swaps.¹³

The current restrictions on enumerated agricultural options, which only may be offered to a counterparty that has at least \$10 million in net worth and is entering into the option for hedging purposes, is an unnecessary hurdle that prevents many market participants with legitimate commercial or investment interests from using agricultural options. No additional obligations are needed under the Dodd-Frank framework because it already provides for increased regulatory oversight of all commodity swaps and options. Under the Dodd-Frank Act, most OTC derivatives will have to be cleared through regulated DCOs and subject to reporting and other protections. Consequently, any concerns that might previously have existed with respect to OTC options in enumerated agricultural commodities should not prevent them from being treated the

¹² Dodd-Frank Act § 721(a)(21) (to be codified at CEA § 1a(47)).

¹³ Proposed Rule, 75 Fed. Reg. at 65589.

same as other swaps and options under the Dodd-Frank Act. The Commission should therefore, replace Parts 32 and 35 of its regulations with new regulations that treat all agricultural options and swaps consistently.

IV. CONCLUSION

Gavilon commends the Commission's efforts to protect consumers by bringing more transparency and oversight to the OTC derivatives markets generally and to agricultural markets specifically. Gavilon also recognizes the complexity involved in such significant reform and submits its comments to ensure that the Commission has a fuller understanding of how to craft its implementing regulations in order to reduce any unintended negative impacts on the market. We welcome the opportunity to discuss these issues further with the Commission and its Staff.

Please contact Edward Prosser, at (402) 889-4454, if you have any questions regarding Gavilon's comments.

Respectfully submitted,



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