

October 28, 2010

VIA E-MAIL

Mr. David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Agricultural Swaps ANPRM

Dear Mr. Stawick:

We are submitting this letter on behalf of our clients, Teucrium Trading, LLC (“Teucrium Trading”) and Teucrium Commodity Trust (the “Trust” and, together with Teucrium Trading, “Teucrium”). Teucrium appreciates the opportunity to offer its comments in response to the request for comment by the U.S. Commodity Futures Trading Commission (the “Commission”) in its Advanced Notice of Proposed Rulemaking on agricultural swaps (the “ANPRM”).¹ The ANPRM requests comment on a number of matters relating to the regulation of derivatives on agricultural commodities in light of the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).²

Teucrium is a commodity pool operator registered under the Commodity Exchange Act (the “CEA”) that is in the business of operating exchange-traded commodity pools that are series of the Trust (the “Funds”).³ Only one such Fund, the Teucrium Corn Fund (the “Corn Fund”), is currently in operation, but Teucrium expects that other Funds, some of which will invest in agricultural commodity derivatives, will commence operations in the near future. The Corn Fund has, and each other Fund that is currently planned is expected to have, an investment objective of tracking the performance of a benchmark consisting of three exchange-traded futures contracts for a specified commodity. While each Fund, in order to meet its investment

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

² Public Law 111-203, 124 Stat. 1376 (2010).

³ The Trust is a statutory trust organized under the Delaware Statutory Trust Act. Each Fund is a separate series of the Trust. As such, the assets of each Fund include only those assets allocable to that Fund, and the Sponsor intends to operate each Fund so that, under Delaware law, it will be liable only for obligations attributable to such Fund and will not be liable for the obligations of any other Fund.

objective, will invest primarily in futures contracts and/or swap agreements that are currently cleared through an appropriate clearinghouse, each Fund may in certain circumstances enter into over-the-counter derivative contracts on the specified commodity. None of the Funds intend to use leverage, in that the value of a Fund's cash and cash equivalent holdings will at all times approximate the notional amount of such Fund's derivative holdings. Nor do any of the Funds intend to enter into or hold next-to-expire or "spot month" futures contracts or equivalent over-the-counter derivative contracts, except that spot month contracts that were formerly second-to-expire contracts may be held for a brief period until they can be disposed of in accordance with the Fund's roll strategy.

Executive Summary

Initially, Teucrium submits that no compelling reason currently exists to subject agricultural swaps to more stringent requirements than other commodity swaps.⁴ In addition, Teucrium generally supports the goal of requiring that standardized swap transactions be cleared, a goal that it believes is reflected in the provisions of the Dodd-Frank Act. However, Teucrium believes that any such clearing requirements must take into account two vital considerations:

- Many market participants desire to enter into transactions that are customized in light of their particular needs and, due to such customization, it is not practical that such transactions be cleared. Accordingly, requiring that all contracts with respect to a particular commodity be cleared would effectively prohibit these customized transactions, a result that would not be consistent with the public interest.
- Any requirement that will result in a significant amount of current over-the-counter activity being subject to mandatory clearing will cause a corresponding increase in volume in markets where trading is or would be subject to position limits. Accordingly,

⁴ As a historical matter, agricultural commodity derivatives have sometimes been regulated more strictly than derivatives relating to other types of commodities. For example, the Commodity Futures Modernization Act of 2000 specifically excluded "agricultural commodities" from its provisions exempting of certain bilateral over-the-counter swaps from the Commission's jurisdiction. This more stringent regulation of agricultural derivatives may stem from the perception in the 1920s and 1930s that agricultural markets were particularly subject to manipulation. See Remarks of Commissioner Michael V. Dunn before the American Public Gas Association's Annual Meeting - Albany, NY (August 7, 2007), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/CommissionerMichaelDunn/opadunn-8.html>. Today, many agricultural commodities trade in very active and liquid markets. Furthermore, one of the purposes of the Dodd-Frank Act appears to be to subject non-agricultural swaps to stricter regulation akin to that currently applicable to agricultural swaps. See, e.g., Section 737(a)(4) of the Dodd-Frank Act (calling for the Commission to establish position limits on derivatives with respect to "physical commodities other than excluded commodities as defined by the Commission").

any such requirement ought to be accompanied by a significant increase in the currently applicable position limits relating to those commodity contracts.

Comments

I. The Need to Continue to Permit Customized Transactions

Pursuant to the Dodd-Frank Act, the Commission is directed to determine, based on certain factors, whether a swap, or a group, category, type, or class of swaps, should be required to be cleared.⁵ Such factors include: (1) the existence of significant outstanding notional exposures, trading liquidity and adequate pricing data; (2) the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contracts on terms consistent with those on which the contracts are currently traded; (3) the effect on the mitigation of systemic risk; and (4) the effect on competition, including appropriate fees and charges applied to clearing.⁶ Because any swap that is required to be cleared will from an operational standpoint need to be standardized to some degree, any Commission determination that all swaps on a particular agricultural commodity must be cleared would effectively prohibit market participants from entering into customized swaps that may be best suited to their specific objectives. Accordingly, while Teucrium supports the mandatory clearing of agricultural swaps with terms closely resembling those of futures contracts that are currently traded on United States futures exchanges, Teucrium also strongly believes that the Commission should accommodate the needs of market participants to enter into customized transactions by not subjecting such customized transactions to clearing requirements.

To the extent that an agricultural swap contract resembles a futures contract traded on a United States exchange, in terms of factors such as the underlying commodity, expiration date, and contract size, the Commission should require that such swap contract be cleared. Teucrium believes that the required clearing of such swaps would promote rather than limit market participants' ability to pursue their hedging and other objectives, and would do so without placing an undue burden on competition or the trading infrastructure.

⁵ Dodd-Frank Act, § 723(c)(3)(A).

⁶ The Dodd-Frank Act provides that swaps in "agricultural commodities" (as defined by the Commission) are prohibited unless entered into pursuant to a rule, regulation, or order of the Commission adopted pursuant to section 4(c) of the Commodity Exchange Act (including any such rule or regulation currently in effect). Dodd-Frank Act, § 723(c)(3). We are operating under the assumption that the Commission is not prohibited under this provision from amending the currently effective rules permitting agricultural swaps in order to impose mandatory clearing requirements.

Conversely, we note that certain market participants rely on customized swaps to create commodity products that meet a specialized hedging or investment goal. Mandating the clearing of swaps of this nature would hinder the ability of market participants, including participants at various levels of a commodity's supply chain, to hedge their commodity positions effectively. The exclusive use of cleared swaps would effectively permit only swaps with certain specified notional amounts, expiration dates, and underlying commodities and, as a result, no swap may be available that will completely transfer the risks faced by a particular market participant. Specifically with respect to the Funds, each Fund has an investment objective specified in its offering materials of tracking the performance of a benchmark consisting of three exchange-traded futures contracts for a specific commodity, and each Fund may, in order to best track its benchmark, find it beneficial to enter into customized swaps based on the blended performance of the benchmark's component futures contracts.⁷ Teucrium submits that permitting Fund shareholders to realize returns that reflect the objective described in a Fund's prospectus and marketing materials is sound public policy that does not conflict with the goals of the Dodd-Frank Act.

Furthermore, continuing to permit customized swaps without a clearing requirement is consistent with the specific factors set forth in the Dodd-Frank Act that the Commission must consider in determining whether a type of swap should be cleared. First, we note that, because of their customization, customized swaps are unlikely to have significant outstanding notional exposures or to present significant systemic risk. In addition, the administrative difficulties and monetary costs of clearing customized swaps would produce an enormous burden on the United States' clearing infrastructure on account of the sheer quantity and diversity of swaps that are currently traded in the over-the-counter market. In this regard, Teucrium notes that a determination to require that most or all customized swaps be cleared would present issues in terms of the factor set forth in the Dodd-Frank Act regarding "availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure." While infrastructure can be improved and resources can be increased, the significant increases in staff and systems capacity that would be necessary to clear most or all customized swaps would result in substantially increased costs that will ultimately be borne by market participants, including commodity producers and end users. Furthermore, Teucrium believes that, even with infrastructure changes, requiring the clearing of customized swaps might result in time delays and a general lack of efficiency in the market for cleared swaps, and could even threaten to overwhelm the clearing system generally and negate any benefits of clearing standardized swaps.

⁷ In addition, the Funds may enter into customized swaps with the goal of alleviating deviation between the Fund's performance and that of its benchmark that may result from market or trading inefficiencies.

For the reasons set forth above, Teucrium strongly believes that the Commission should require that only certain standardized agricultural swaps, particularly those that resemble futures contracts currently traded on United States futures exchanges in terms of underlying commodity, expiration date, and contract size, be cleared.

II. The Need to Provide Position Limit Flexibility

Teucrium believes that, to the extent that a significant amount of activity that is currently conducted on a purely over-the-counter basis is required to be cleared under any new regulatory regime, existing position limits should be increased significantly to accommodate the increased activity in instruments that will be subject to position limits.

As the Commission is aware, position limits on futures contracts for many agricultural commodities are set forth in Commission regulations.⁸ Cleared agricultural swaps are generally subject to separate but comparable position limits imposed by the clearinghouse through which those swaps are cleared.⁹ Section 737 of the Dodd-Frank Act provides that the Commission shall adopt position limits for futures contracts, exchange traded options, and swaps that are economically equivalent to futures and exchange-traded options.¹⁰

First, we respectfully assert that the types of customized swaps discussed in the preceding section that Teucrium believes should not be subject to mandatory clearing are not the “economic equivalent” of futures contracts, and do not perform a significant price discovery function. Customized swaps of the nature that the Funds would enter into would typically not be the economic equivalent of futures contracts in terms of expiration date, contract size and, potentially, other characteristics. Furthermore, because entering into these customized swaps would generally not serve any economic purpose for an entity other than the Fund, they are unlikely to serve any price discovery function. Teucrium respectfully suggests that no substantial regulatory purpose would be served subjecting these swaps to position limits.

Second, as to more standardized swaps, it is important to note that the size of the market for pure over-the-counter derivatives not currently subject to position limits is much larger than

⁸ See 17 CFR §150.2.

⁹ See, e.g., Chicago Board of Trade Rulebook, Position Limit, Position Accountability and Reportable Level Table.

¹⁰ Section 737 also amends Section 4a of the CEA to give the Commission authority to impose position limits on swaps not traded on or subject to the rules of a designated contract market or a swap execution facility that performs a significant price discovery function with respect to a registered entity.

that for either futures contracts or cleared swaps.¹¹ Accordingly, Teucrium believes that, if substantial amounts of agricultural swaps were to be required to be cleared without appropriate changes to position limits, many market participants would be unable to enter into derivative transactions that may be economically beneficial and/or necessary to appropriately hedge the market participants' positions. In the case of the Funds, this could be the case irrespective of the size of the particular Fund and whether it enters into commodity positions subject to position limits, because the counterparties with which the Fund deals may have to limit their trading. If the Fund's counterparties face restrictive position limits, they may not be willing to enter into transactions with the Funds or may effectively sell their position limit space to the highest bidders, effectively increasing transaction costs for the Funds and others. Even if a Fund were able to enter into a position that is not subject to position limits, the counterparty may need or desire to hedge its exposure through contracts subject to position limits, effectively bringing any position limits back into play.¹²

As noted in Section 4a of the CEA, the purpose of speculative position limits is to mitigate the burden on interstate commerce posed by excessive speculation. While the Funds may be speculators in that they are not hedging risks associated with their dealings in a specified physical commodity (*i.e.*, they are not producers or users of such commodities), it should be noted again that, unlike many if not most other commodity pools, the Funds are not leveraged. Teucrium respectfully suggests that entities that do not use leverage present far less possibility for the type of "excessive speculation" addressed by Section 4a. By limiting the notional amount of its exposure to the value of its cash and cash equivalent holdings, a Fund should not have difficulty meeting ongoing margin or collateralization requirements or liquidating positions in response to redemptions of Fund shares. Furthermore, in light of the publicly-disclosed benchmark-tracking objectives of the Funds, Teucrium has no discretion to engage in a more speculative trading strategy. Accordingly, Teucrium suggests that the Commission consider imposing substantially more liberal position limits on entities such as the Funds that do not use

¹¹ According to Bank of International Settlements data, the aggregate notional amount of over-the-counter commodity derivatives outstanding as of December, 2009 was \$2.944 trillion. In contrast, 20.7 million contracts were outstanding globally on organized exchanges as of December, 2009. *See* BIS Quarterly Review (Sept. 2010), at 124, 126. Assuming an average contract size of \$25,000, the aggregate notional amount of exchange traded contracts would be approximately \$518 billion, substantially less than \$2.944 trillion.

¹² For example, if a Fund were to take a long position in a swap based on the combined performance of the futures contracts that make up its benchmark, it is unlikely that the Fund's counterparty could hedge its short position by entering into a long position on a comparable combined swap, because, as noted above, third parties are unlikely to be interested in taking positions based on the Fund's benchmark. Accordingly, the counterparty would need to use the underlying futures contracts, or separate swaps each based on one of those underlying futures contracts, to hedge its transaction with the Fund, and these instruments would likely be subject to position limits.

leverage.¹³ In addition, the fact that an entity does not hold spot month futures contracts or equivalent swaps tends to minimize any possibility that it will engage in the excessive speculation that Section 4a attempts to mitigate. Therefore, Teucrium also suggests that the Commission impose substantially more liberal position limits with respect to non-spot month positions or on entities such as the Funds that do not generally enter into or hold spot month positions.¹⁴

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Again, Teucrium appreciates the opportunity to comment on the ANPRM, and would be pleased to discuss any questions the Commission may have with respect to this letter. Any questions about this letter should be directed to Tom Conner of Sutherland at (202) 383-0590 or Eric Freed of Sutherland at (212) 389-5055.

Respectfully Submitted,
SUTHERLAND ASBILL & BRENNAN LLP

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¹³ We note that the Commission has previously granted no-action relief from applicable position limits to a fund similar to the Funds, and that such no-action relief was later withdrawn. *See* Commission Letter No. 06-09 (May 6, 2006), withdrawn in Commission Release PR5696-09 (Aug. 19, 2009). Teucrium does not assert that it should be subject to no position limits on standardized swaps, but rather that the position limits to which it is made subject take into account the non-leveraged nature of the Funds' investment strategies.

¹⁴ Teucrium recognizes that existing position limits typically set forth a separate, lower limit on the number of spot month contracts that may be held. Teucrium merely asserts that the difference between the spot month position limit on the one hand and the per-month and overall position limits on the other should be adequate to take into account the magnitude of the burden that spot month trading may place on interstate commerce.