C A D W A L A D E R

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VIA ELECTRONIC SUBMISSION

David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Aggregation of Positions for Position Limit Purposes

Dear Mr. Stawick:

On January 26, 2011, the Commodity Futures Trading Commission ("Commission") published a Notice of Proposed Rulemaking regarding Position Limits for Derivatives ("Proposed Rule")[1] pursuant to Section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). Section 737(a) adds new Section 4a(a)(6) of the Commodity Exchange Act ("CEA"), which requires the Commission to establish limits on the aggregate positions in certain futures and other derivatives contracts.[2]

Related to the above rulemaking, we understand that Commission staff are considering the extent to which certain control and ownership criteria should be taken into account when evaluating whether positions of affiliated entities must be aggregated. In particular, staff are reviewing whether, absent actual common control: (1) the existence of a payment guaranty between two affiliated entities is sufficient to require aggregation of both entities' positions for position limit purposes; and (2) the existence of a common system of financial accounting between a parent corporation and its subsidiaries is sufficient to require aggregation of the positions of the parent and subsidiaries.

On behalf of Hess Corporation and its affiliates (collectively "Hess"), we submit these comments consistent with the Notice of Acceptance of Public Submissions issued by the Commission.[3] Respectfully, payment guarantees and systems of common accounting, in and of

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[1] *Position Limits for Derivatives*, 76 Fed. Reg. 4752 (Jan. 26, 2011) (Notice of Proposed Rulemaking).

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

[3] *Acceptance of Public Submissions on the Wall Street Reform and Consumer Protection Act and the Rulemakings that Will be Proposed by the Commission*, 75 Fed. Reg. 52512 (Aug. 26, 2010).

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themselves, do not present the risk of: (1) market manipulation posed by concentration of positions; (2) disruption to market integrity caused by excessive speculation; or (3) other similar burdens on interstate commerce that Congress sought to remedy through the use of position limits. Accordingly, Hess believes that, consistent with longstanding commercial practice under the CEA, the mere existence of a payment guaranty or a common accounting system, without more, does not necessitate aggregation.[4]

I. Description of Hess

Headquartered in New York, Hess is a fully integrated energy company engaged in the exploration for and the development, production, purchase, transportation and sale of crude oil, and the manufacturing, purchase, transportation, and marketing of refined petroleum, natural gas, and electricity. Hess is listed on the New York Stock Exchange. Hess' subsidiaries are involved in exploration and production operations located in the United States, United Kingdom, Norway, Denmark, Equatorial Guinea, Algeria, Malaysia, Thailand, Russia, Gabon, Azerbaijan, Indonesia, and Libya. Hess' international portfolio has also recently grown to include new licenses in Australia, Egypt, Ghana, Norway, Ireland, Russia, Brazil and Peru.

Hess' Energy Marketing division markets refined oil products, natural gas, and electricity to a vast array of utilities and other industrial and commercial customers located from the Ohio Valley to the East Coast. Hess enters into derivatives contracts to manage the fixed price risk associated with this activity. In addition, Hess operates a network of strategically located petroleum storage terminals that support its marketing operations. Through subsidiaries and joint venture agreements, Hess also operates a fluid catalytic cracking unit in Port Reading, New Jersey, and the Hovensa Refinery in the U.S. Virgin Islands. Hess' Supply, Trading and Transportation division markets several hundred thousand barrels per day of crude oil and gas liquids, and trades (purchases and sells) hundreds of thousands of physical barrels per day of refinery feedstocks, intermediates, and finished petroleum products. Hess also enters into derivatives contracts to manage the price risk associated with this activity.

Hess Energy Trading Company, LLC ("HETCO") is a Delaware limited liability company established in 1997. HETCO recently organized a branch in the Dubai International Financial Center and operates with three United Kingdom corporations, two of which are registered with the Financial Services Authority, a Cayman Islands exempted company, and a corporation organized in Singapore. These entities are used in the continually evolving development and implementation of a worldwide energy trading strategy effectuated by a series

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[4] To the extent the Commission concludes that the Dodd-Frank Act may require a contrary result, Hess respectfully submits that the Commission may rely on the broad exemptive authority provided in CEA Section 4a(a)(7) to provide relief for affiliated entities that are independently managed and controlled currently, and that currently rely on a payment guaranty or that operate under a common accounting system. Hess believes that such an exemption would help to ensure sufficient liquidity in, and to protect the price discovery function of, the derivatives markets.

of spot and forward purchase and sales agreements, equity, foreign exchange, physical oil storage and chartered vessel transactions from time to time, swaps and other derivative transactions in crude oil, petroleum products, natural gas, and power, and freight transactions.

II. The CEA Requires Aggregation Based on Actual Common Control

CEA Section 4a, as originally passed by Congress in 1936, requires the Commission, when determining whether any person has exceeded its position limits, to include any positions "held and trading done by any persons directly or indirectly controlled by [that person]," in addition to positions held by, and trading done by "two or more persons acting pursuant to an expressed or implied agreement or understanding."[5] Congress provided the Commission with this authority to address the concern that a single person could cause "sudden or unreasonable fluctuations or unwarranted changes in the price of [a] commodity" through the build-up and unwinding of distinct, but connected derivatives positions.[6] Over time, the Commission came to view position limits as a further tool to deter manipulation, by restricting the size and concentration of positions around the expiration of the prompt month futures contract.[7]

Because it is possible for a trader to evade position limits by either allocating an excess position among several accounts (thereby concealing ownership of the position) or colluding with other traders regarding the management of separately owned accounts (thereby concealing control over the positions), the CEA also provides for aggregation of positions that are under the common control of a single trader.[8] Significantly, the Commission has historically interpreted this as a requirement to apply aggregation not only as to *ownership of positions*, but also as to *control of trading decisions* regarding positions.[9]

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[5] CEA § 4a(a).

[6] *Id*.

[7] *See generally Significant Price Discovery Contracts on Exempt Commercial Markets*, 74 Fed. Reg. 12178 (Mar. 23, 2009). DCMs are required to adopt position accountability levels for trading during the delivery month "to reduce the potential threat of market manipulation or congestion . . . ." CEA § 5(d)(5).

[8] The Commission affirmed the dual role of ownership and control indicia with respect to the aggregation requirement when it issued the most recent revisions to the Part 150 speculative position limits rules: "By proposing to codify the substance of the 1979 Aggregation Policy, the Commission did not intend to narrow its interpretation or application." *Revision of Federal Speculative Position Limits and Associated Rules*, 64 Fed. Reg. 24038, 24044 (May 5, 1999) (Final Rule).

[9] *See id.* at 24043. Consistent with this view, the current federal position limits established by the Commission for agricultural commodities follow a similar structure. *See* 17 C.F.R. 150.5(g) (2010) ("In determining whether any person has exceeded the limits established under this section, all positions in accounts for which such person by power of attorney or *otherwise directly or indirectly controls trading* shall be included with the positions held by such person; such limits upon positions shall apply to positions held by two or more person (sic) acting pursuant to an express or implied agreement or understanding, the same as if the positions were held by a single person.") (emphasis added).

Consistent with the express language of the CEA, position limits imposed by designated contract markets ("DCMs") have historically been based on common control.[10] For example, the aggregation rules of the Chicago Mercantile Exchange require aggregation of positions "in accounts for which a person by power of attorney or otherwise directly or indirectly *owns the positions* or *controls the trading* of the positions[, including] positions held by two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading of the positions was done by, a single person."[11] The Rules of ICE Futures U.S. and the CBOE Futures Exchange have substantially similar requirements.[12] Likewise, under the currently regulatory framework, entities seeking to disaggregate positions held by affiliated, but separately controlled, entities must submit to the DCM an explanation of the circumstances that warrant disaggregation. This control-based model for aggregation has been used effectively by exchanges for years to deter manipulation and to prevent excessive speculation.

Given the purposes underlying position limits (*i.e.*, to diminish, eliminate, or prevent excessive speculation) and the process the Commission and the exchanges have followed historically to determine which positions should be subjected to such limits, neither the existence of a guaranty or other standard credit agreement between affiliated entities, nor a common system of financial accounting, are informative in this regard. Guarantees and methods of accounting do not speak to whether one affiliate exerts control over another affiliate.[13] Rather, the existence of such arrangements are relevant, if at all, to the potential risk posed by the guarantor's participation in the markets, not excessive speculation.

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[10] DCMs generally have been first movers in imposing positions limits on contracts traded on their markets. Many DCMs imposed position limits or accountability levels on energy and metals contracts before the Commission proposed rules requiring position limits for exempt commodities. *See* 75 Fed. Reg. at 4146, n. 16 and accompanying text. When adopted, exchange-based limits have typically relied upon a pragmatic, control-based test to determine whether or not to aggregate the positions of affiliated entities.

[11] CME Rule 559.D (emphasis supplied).

[12] CBOE Futures requires aggregation of positions as follows: "by power of attorney or otherwise, [a trader who] directly or indirectly controls trading (whether on a proprietary basis or on behalf of Customers) shall be included. Position limits shall apply to positions held by two or more Trading Privilege Holders acting pursuant to an express or implied agreement or understanding in the same manner as if such positions were held by a single Person." CBOE Futures Exchange Rulebook, Rule 412(f). ICE Futures requires aggregation of "all positions held by any Person, including those positions in accounts for which such Person by power of attorney or otherwise directly or indirectly controls trading; and in the case of positions held by two (2) or more Persons acting pursuant to an express or implied agreement or understanding, the same as if all of the positions were held by a single Person." ICE Futures U.S. Rulebook, Rule 6.12(a). A "Person" is defined as an "individual or Firm," and "Firm" is a "corporation, partnership, limited liability company, sole proprietorship or other entity."

[13] DCMs have permitted many affiliated entities that operate with guarantees or consolidated financial statements to maintain separate position limits for over a decade. Implicitly, these DCMs determined that typical credit arrangements and accounting systems do not result in a entity's loss of independent management or control.

III. Guarantees are not Indicative of Control over Trading Decisions

Payment guarantees are common financial arrangements between two distinct legal entities to manage risk associated with both routine operations and specific transactions. Guarantees generally are negotiated on an arms-length basis and can exist between affiliates within a single corporate group and wholly-independent, unaffiliated corporate entities. Even where guarantees exist within a single corporate structure, the guarantor and beneficiary typically retain independent management and control, even if there is a significant credit relationship between those entities. Guarantees and other standard credit arrangements typically do not result in the credit provider controlling the beneficiary of the guaranty in any way.

Hess believes that the Commission should not treat the mere existence of a guaranty as a "proxy" for trading control. Aggregating positions anytime a payment guaranty, lien, letter of credit, or other standard credit arrangement exists between two parties would be over-broad and inconsistent with the purposes that position limits were meant to serve. Indeed, because a guaranty does not provide the guarantor with access to information or control over the trading decisions of the guaranteed party, Hess believes that such an aggregation requirement would do nothing to reduce "excessive speculation" or the risk of "sudden or unreasonable fluctuations or unwarranted changes in the price of [a] commodity."[14] On the contrary, aggregating independently controlled positions based merely on the existence of a payment guaranty potentially would *remove* participants from the market, *diminish* liquidity for bona fide hedgers, and *reduce* the quality of price discovery in the underlying market.[15] This is inconsistent with the original purpose of CEA Section 4a (*i.e.*, to diminish, eliminate, or prevent excessive speculation), and the new requirements established by the Dodd-Frank Act (*i.e.*, promoting market integrity, preserving adequate liquidity for bona fide hedgers, and protecting the price discovery function of the underlying market).

Similarly, Hess is concerned that aggregating positions based on the presence of a guaranty also could force legally separate entities to share confidential, proprietary position and trading information in order to comply with position limits.[16] Such a requirement would be a radical departure from current practice, and could substantially discourage credit arrangements that actually enhance investment, liquidity, and responsible risk management. Moreover, in certain circumstances, applicable law may actually prohibit separately managed business lines

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[14] CEA § 4a(a)(1).

[15] Firms that are forced to aggregate positions held in independently managed accounts are likely to coordinate management of such accounts. Such coordination would reduce the quantity of independent trading decisions and price determinations made in the market as a whole, causing reduced market liquidity and increased volatility.

[16] In certain circumstances, applicable law may prohibit such separately managed business lines from sharing position and trading information. For example, the Federal Energy Regulatory Commission imposes restrictions between public utilities with captive customers and power sales affiliates with market-based rate authority.

from sharing position and trading information. For example, the Federal Energy Regulatory Commission imposes restrictions between public utilities with captive customers and power sales affiliates with market-based rate authority. In such cases, which are particularly common in the energy industry, market participants would be unfairly forced to divide the applicable position limits among its affiliated entities, effectively reducing the position limit dramatically for each individual entity.

The Commission has acknowledged that the increasingly complex organization of many commodity market participants requires aggregation rules that are sensitive to the actual extent to which common control exists between otherwise independent firms.[17] Accordingly, Hess respectfully submits that the Commission should adopt a position limits rule that does not unnecessarily commingle the separate issues related to credit and control. A credit relationship between two parties does not indicate coordination of trading between the parties, and more practically, does not suggest that the parties are more likely to manipulate the market or engage in excessive speculation by acting jointly. Nevertheless, to the extent the Commission believes that the Dodd-Frank Act mandates increased scrutiny of the credit exposure of swap counterparties, Hess respectfully submits that the effect of a guaranty is most relevant to the financial condition and relative credit risk of the parties, not the parties' market power or the risk of "excessive speculation." Accordingly, Hess encourages the Commission's to address this and other credit issues in its rules implementing minimum capital requirements rather than in the context of position limits and the prevention of excessive speculation.

IV. A Common System of Financial Accounting is not Indicative of Control over Trading Decisions

Corporations account for their finances in many different ways. Many corporations have consolidated financial statements that combine the profit and loss of affiliates with the profits and losses of the parent company. Whether a firm consolidates its subsidiaries into the parent's financial statements is generally a question of generally accepted accounting principles ("GAAP") and the rules of the Financial Accounting Standards Board ("FASB").[18] The purpose of consolidated financial statements is to present, primarily for the benefit of the owners and creditors of the parent, the results of operations and the financial position of the parent and its subsidiaries "as if the consolidated group were a single economic entity."[19] In other words, consolidated financial statements are intended to give shareholders of the parent company the best picture possible of the financial condition of the parent, irrespective of the legal separateness of the parent and its consolidated subsidiaries. A system of common accounting between a parent company and its subsidiaries may be indicative of some level of corporate equity

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[17] *See* 64 Fed. Reg. at 24044 (discussing CFTC Interpretive Letter 92-15).

[18] Under GAAP and the rules of the FASB, a company that owns a majority voting interest in another company generally is required to consolidate the subsidiary's books with its own.

[19] *See* FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (Dec. 2007).

ownership in a subsidiary, but it does not indicate that the parent has *control* over the activities of the subsidiary. The mere fact that a subsidiary's positions roll into the books of a parent entity should not be a basis for aggregating their positions.

Companies that are able to demonstrate the independence of a subsidiary should not be required to aggregate their positions, regardless of how GAAP requires firms to report profits and losses. Two contrasting parent-subsidiary relationships outlined below (Company A and Company B) show why consolidated financial statements do not evidence coordination of trading between the parent and subsidiary.

Company A. In some cases, a common system of financial accounting may evidence significant integration between a parent and subsidiary, such as when a parent has consolidated all of its commodity business in a single affiliated entity. In such an arrangement, the affiliate may be acting essentially as the parent's agent in executing trades on a discretionary basis, but consistent with the parent's overall business strategy and trading objectives. Under current practice, such a structure likely would merit aggregation of the affiliated entities' positions with the parent's positions.[20]

Company B. In other cases, a corporation may take an equity interest in a proprietary trading company as an investment. Separately, the corporation continues to access the over-the-counter derivatives markets for its own account to facilitate its needs as a commercial operating company. Thus, even though FASB rules may require the corporation to prepare consolidated financial statements that include the profits and losses of the trading affiliate, the two entities operate independently under separate management and with distinct business objectives. The parent would not be able to direct or influence the trading of the affiliate, either directly or indirectly (particularly where the parent's interest in the affiliate is substantially less than 100%). Similarly, the affiliate's trading would not be done on behalf of the corporation or to further the corporation's business. In such a scenario, aggregation between the two affiliated entities would be inappropriate and inconsistent with current commercial practice.[21]

Hess respectfully submits that consolidated financial statements do not demonstrate actual common control by the parent over the day-to-day trading decisions of its subsidiary. A

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[20] *See, e.g., Statement of Policy on Aggregation of Accounts and Adoption of Related Reporting Rules*, 44 Fed. Reg. 33839, 33843 (Jun. 13, 1979).

[21] *See, e.g.*, CFTC Interpretative Letter 92-15; 64 Fed. Reg. at 24044.

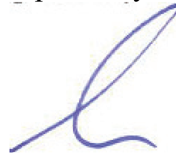
rule that aggregates positions based on the accounting systems would, without more, be unnecessarily broad and an inefficient way to implement the intended purposes of position limits provision in the CEA.

V. Conclusion

On behalf of Hess, we believe the Commission should reaffirm that actual common control of trading decisions is the decisive issue in aggregation determinations. Furthermore, we hope the comments we have offered regarding guarantees and other standard credit arrangements and common systems of financial accounting among affiliates will help to reinforce for the Commission why such relationships, standing alone, do not evidence common control as to the trading decisions of otherwise independent firms.

We are available to answer any additional questions you may have at your convenience.

Respectfully submitted,



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