



AIR TRANSPORT ASSOCIATION

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April 4, 2011

*FILED ELECTRONICALLY*

David A. Stawick  
Secretary, Commodity Futures Trading Commission  
3 Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

Re: "Commodity Options and Agricultural Swaps," 76 *Fed. Reg.* 6095 (Feb. 3, 2011) RIN:  
3038-AD21

Dear Mr. Stawick:

The Air Transport Association of America, Inc. ("ATA") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("Commission") proposed rules, "Commodity Options and Agricultural Swaps," 76 *Fed. Reg.* 6095 (Feb. 3, 2011) (the "Proposal"). Section 21 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")<sup>1</sup> amended the Commodity Exchange Act, 7 U.S.C. §1 *et seq.* ("Act") by adding a definition of "swap." The proposed rules, in part, address issues arising from that definition. ATA recommends that the Commission confirm that certain variable amount delivery contracts, described below, are excluded from the definition of "swap."

**ATA**

ATA is the principal trade and service organization of the U.S. scheduled airline industry. It is the nation's oldest and largest airline trade association and its members account for more

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<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203, 124 Stat. 1376 (2010).

<sup>2</sup> The members of the association are: ABX Air, Inc.; AirTran Airways; Alaska Airlines, Inc.; American Airlines, Inc.; ASTAR Air Cargo, Inc.; Atlas Air, Inc.; Continental Airlines, Inc.; Delta Air Lines, Inc.; Evergreen International Airlines, Inc.; Federal Express Corporation.; Hawaiian Airlines; JetBlue Airways Corp.; Southwest Airlines Co.; United Airlines, Inc.; UPS Airlines; and US Airways, Inc. Associate members are: Air Canada; and Air Jamaica.



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than 90 percent of the passenger and cargo traffic carried by U.S. airlines. Since its founding in 1936, ATA has encouraged governmental policy decisions that foster a financially stable U.S. airline industry capable of meeting the nation's travel and shipping needs and competing in the global economy, while withstanding the inherently cyclical nature of the airline industry.

ATA members are significant purchasers of jet fuel. They also engage in sophisticated hedging programs to manage their fuel cost exposure and, accordingly, have experience in transacting in both the cash and over-the-counter (“OTC”) swaps markets.

### ***The Proposed Rules***

The Commission is proposing to remove nearly all of the regulations governing OTC options, and to supersede Commission rule 32.4, 17 C.F.R. §32.4, as it currently reads. Currently, rule 32.4 provides an exemption from all Commission rules (except those relating to misrepresentation and fraud), for commodity options reasonably believed to be offered to a producer, processor, or commercial user of, or a merchant handling, the commodity which is the subject of the option transaction and that is entered into by the producer, processor, commercial user or merchant for a business-related purpose. This is commonly known as the “trade option exemption.” The Commission is proposing to replace rule 32.4 with a new rule that provides that persons may conduct activities relating to options under the provisions of the Act and Commission rules applicable to swaps.

The Commission explains that although the trade option exemption since 1976 “has provided legal certainty for that segment of the commodity options market available to commercial end users,” it is proposing to remove the trade option exemption based upon the rationale

that the swaps rules already allow for the equivalent of a trade option—the Dodd-Frank amendments permit bilateral swaps, where both parties are ECPs [Eligible Contract Participants] to remain uncleared at the election of a commercial end user.

Proposal at 6102.

The Commission continues by noting that in its view the “primary substantive change to this market will be that, while current §32.4 imposes no minimum net worth requirement on participants, both purchasers and sellers of commodity options under revised §32.4 will have to qualify as ECPs. *Id.* The Commission requests comment “as to whether this distinction will significantly affect hedging opportunities available to currently active market participants.” *Id.*

### ***Superseding the trade option exemption without clarification would adversely impact airlines***

Although the Commission concludes that removal of the trade option exemption will have very limited impact on market participants, the regulatory requirements that apply to transactions under the swaps end-user exemption are far more burdensome than the minimal requirements that apply under the trade option exemption. Swap transactions, even those under the end-user exemption, include reporting and recordkeeping requirements for one or both counterparties and possible registration requirements for one of the counterparties, along with associated business conduct and possible margin and capital requirements. These burdensome

regulatory requirements are not appropriately applied to purely cash market transactions, as Congress recognized, by excluding from the definition of “swaps” nonfinancial deferred delivery contracts.

Section 721 of the Dodd-Frank Act defines a “swap” to include “an option of any kind that is for the purchase or sale, or based on the value, of . . . commodities.” It also includes an exclusion from the definition of “swap” for “any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled.”<sup>2</sup> This exclusion was clearly intended by Congress to ensure that cash market transactions, including contracts for deferred delivery, are not subject to regulation as a swaps contract. This is the same judgment that Congress made in excluding forward contracts from futures regulation in 1921.

There are no bright line tests for differentiating cash forward contracts from regulated swaps (or futures) transactions.<sup>3</sup> In this regard, it should be noted that the definition of “option” under the Act is imprecise<sup>4</sup> and “forward contract” and “futures contract” are undefined.<sup>5</sup> Because of this lack of precision, many in the cash markets have, over the years, come to rely upon various exclusions, exemptions and Commission interpretations for legal certainty, including the trade option exemption of rule 32.4. Accordingly, if the Commission removes the safe harbor of the trade option exemption, it becomes increasingly important to differentiate between cash markets and swaps.

#### ***Variable delivery cash market transactions in jet fuel are not swaps***

ATA members engage in a variety of cash market transactions for the purchase of jet fuel. Typically, they may enter into a long-term contract to purchase jet fuel from one or more different suppliers at any number of specific locations. These contracts may be for a fixed amount to be delivered each month, or more likely, may provide the airline with the ability to specify an exact quantity for delivery each month within a minimum and maximum amount. The airline decides on how much product to have delivered within the agreed upon range, generally during the month prior to delivery, paying only for the amount that it takes. The amount of fuel that the airline takes varies due to seasonal changes in scheduling and other factors. Generally, the fuel is priced based upon a spot index price.<sup>6</sup> There is of course, a wide

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<sup>2</sup> Section 1a(47)(B)(ii) of the Act.

<sup>3</sup> See e.g., “Exemption for Certain Contracts Involving Energy Products,” 58 *Fed. Reg.* 21586 (April 20, 1993).

<sup>4</sup> Section 1a(36) of the Act defines the term “option” as meaning, “an agreement, contract, or transaction that is of the character of, or is commonly known to the trade as, an “option”, “privilege”, “indemnity”, “bid”, “offer”, “put”, “call”, “advance guaranty”, or “decline guaranty”.

<sup>5</sup> The forward contract exclusion under section 1a(27) of the Act is part of the definition of “future delivery.” It provides that part of the definition of “future delivery” does not include any sale of any cash commodity for deferred shipment or delivery.”

<sup>6</sup> Cash prices for jet fuel are determined by price reporting services, such as Platts. In the United States, Platt's determines the cash price of jet fuel at the close of every trading day. It does so by using futures prices on the New

range of variation in terms. For example, some contracts may have a fixed price for the contract minimum with a floating (spot) price for deliveries in excess of the minimum.

The variable delivery amount contracts described above provide the airline purchaser with the right, but not the obligation, to take delivery of amounts of jet fuel between the minimum and maximum amounts specified in the contract. These requirements contracts are not options. Although the purchaser has the right to vary the amount that it takes on delivery from month to month, these contracts do not have many of the characteristics that the Commission traditionally has associated with “options.” For example, these contracts are not “limited risk” contracts in which the “purchaser will benefit from a favorable price move and will not be liable for any other losses beyond the premium or the payment that the purchaser pays for the option.”<sup>7</sup> Accordingly, unlike an option, the purchaser of the jet fuel contract “face(s) the full risk of loss from adverse price changes.”<sup>8</sup>

In differentiating various transactions under the Act, the Commission “has carefully examined ‘the economic reality of the transaction, not its name’ to determine whether an instrument is an option.” Here, the jet fuel contracts provide for the delivery of a variable amount of the commodity in which actual delivery is deferred for commercial convenience. The purchaser has the right to vary the amount that it takes on delivery of the contract from month to month, but is due to its changing needs for the physical commodity and not due to changes in the price level. In all cases, the parties intend to deliver jet fuel. These contracts clearly fall with the exclusion from the definition of “swap” for “any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled.”

***ATA Urges the Commission to confirm that variable delivery contracts are excluded from the definition of “swap”***

ATA urges the Commission, when it adopts a new rule 32.4, to clarify that such variable supply contracts fall within the exclusion from “swaps” for deferred delivery contracts. Because many in the industry previously relied upon the current exclusions in the Act for OTC transactions and on the Commission’s trade option exemption, it is critical that the Commission provide guidance that the range of cash market contracts, including in particular, contracts that provide the purchaser with the right to vary the amount of commodity that it takes for delivery on a monthly basis, fall within the exclusion for deferred delivery contracts.<sup>9</sup> The failure to provide such clarity will cause profound disruption to the cash markets for jet fuel.

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York Mercantile Exchange as a benchmark, and making marginal adjustments on the basis of trading activity in the physical market. The price is further adjusted to reflect locational differentials from the main index pricing point.

<sup>7</sup> See Characteristics Distinguishing Cash and Forward Contracts and “Trade” Options,” 50 *Fed. Reg.* 39656, 39659 (September 30, 1985).

<sup>8</sup> *Id.*

<sup>9</sup> We note that Chairman Gensler in recent testimony stated that it would be appropriate to interpret the exclusion from the definition of “swap” for contracts for deferred shipment of nonfinancial commodities in a manner consistent with the Commission’s previous history of the forward exclusion from futures regulation. See RE:

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ATA appreciates the opportunity to comment on the Proposal. We would be happy to discuss our comments at length with the Commission staff. If you have any questions regarding ATA's comments, please feel free to contact our outside counsel, Paul M. Architzel of Wilmer Cutler Pickering Hale and Dorr LLP at (202) 663-6240, or the undersigned.

Respectfully submitted,

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Commissioner Dunn  
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Defining the Market: Entity and Product Classifications under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Before the House Committee on Agriculture, 112<sup>th</sup> Cong. 1 (2011)(statement of Chairman Gary Gensler.) We concur; but we note that additional guidance is necessary to provide clarity with respect to contracts not addressed by the Commission's prior interpretations, such as those described in our comment letter.