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April 4, 2011

VIA ELECTRONIC SUBMISSION

David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: Notice of Proposed Rulemaking regarding Commodity Options and Agricultural Swaps (RIN 3038-AD21)

Dear Mr. Stawick:

On February 3, 2011 the Commodity Futures Trading Commission ("Commission") published a Notice of Proposed Rulemaking regarding Commodity Options and Agricultural Swaps ("Proposed Rule") pursuant to Sections 721 and 723(c)(3) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1] Hess Corporation and its affiliates (collectively "Hess") appreciate the opportunity to provide the Commission with comments regarding the Proposed Rule.

Of particular concern to Hess are proposed changes regarding the treatment of options on physical commodities.[2] Specifically, the Proposed Rule would treat all commodity options, including options that, by their terms, *require* physical delivery once exercised, as "swaps". Treating all options, financial and physical, as swaps will result in significant unintended consequences for Hess and other commercial entities that rely on physical options to manage their business risk. Hess does not believe Congress intended such a result. On the contrary, Hess believes that the Dodd-Frank Act defines "swap" in a manner that plainly distinguishes between financial and physical transactions. Accordingly, Hess urges the Commission to regulate options in a similar manner by excluding options that are intended to be physically settled once exercised from the definition of "swap".

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1 *Commodity Options and Agricultural Swaps*, 76 Fed. Reg. 6095 (Feb. 3, 2011) (Notice of Proposed Rulemaking).

2 For purposes of this letter, Hess intends for references to "physical options" and "options on physical commodities" to refer only to option contracts that, by their terms, require physical delivery once exercised. This letter does not address option contracts that result in a financial settlement.

I. Description of Hess and its Interest in the Proposed Rule

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. Though 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 or 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 enters into derivatives contracts to manage the price risk associated with this activity as well.

II. Regulating Options on Physical Commodities as Swaps Would Frustrate the Goals of the Dodd-Frank Act and Significantly Disrupt the Risk Management Activities of Commercial End-Users.

Section 721(a) of the Dodd-Frank Act defines "swap" broadly to include, among other things, "option[s] *of* any kind . . . for the purchase or sale, or based on the value, of 1 or more . . . commodities . . . or other financial or economic interests or property of any kind."[3] Based on this language, the Commission concludes that "options on physical commodities . . . are within the Dodd-Frank swap definition."[4] Accordingly, the Commission explains that "[a]ll options on physicals would now be regulated as swaps" under the Proposed Rule.[5] Hess respectfully submits that regulating options on physical commodities as swaps would conflict with Congress's expressed intent in the Dodd-Frank Act and potentially disrupt a wide range of well-established risk management practices.

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

4 76 Fed. Reg. at 6095.

5 76 Fed. Reg. at 6103.

Hess believes that the Dodd-Frank Act unambiguously distinguishes between financial and physical transactions when the definition of "swap" is read in its entirety and in a commercially practical manner. CEA Section 1a(47)(A)(i) provides that the definition of "swap" includes any transaction that provides "for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more . . . commodities . . . and that transfers, as between the parties to the transaction . . . the *financial* risk associated with a future change in any such value or level *without also conveying a current or future direct or indirect ownership interest in an asset* . . ."[6] In contrast, CEA Section 1a(47)(B)(ii) excludes "any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be *physically* settled."[7] By its own terms, the definition of "swap" expressly includes financial transactions and excludes physical transactions. Because options on physical commodities, if exercised, inherently convey an ownership interest in an underlying commodity from one commercial entity to another, Hess respectfully submits that Congress intended to exclude such physical transactions from the definition of "swap."

Excluding options that require physical delivery once exercised from the definition of "swap" is consistent with the Commission's long-standing regulatory approach that distinguishes between financial and physical transactions and would avoid potential conflict between other regulatory requirements. If an option on a physical commodity is treated as a "swap," an entity will be required to comply with clearing and other regulatory requirements imposed on "swaps" by the Dodd-Frank Act. However, when the option is exercised the transaction would become a forward contract that is excluded from the Commission's jurisdiction. Hess believes that it would be commercially impractical and internally inconsistent to regulate the same transaction as a "swap" at one moment and a forward contract at another.[8]

Adopting the new approach to physical options described in the Proposed Rule also would substantially disrupt the operation of many entities that rely on physical options to manage the risks associated with their commercial businesses. For example, petroleum refineries require a constant supply of crude oil to operate reliably and efficiently. Because crude oil is typically transported in large tankers, a single supply disruption that is not remedied in a timely manner could create a shortage that would lead to plant curtailments, output reductions, delivery delays, and other consequential damages. To reduce the risk of such disruptions, many refiners build redundancy into their supply chain. In addition to a primary supplier, a refinery may purchase

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6 Dodd-Frank Act § 721(a)(21) (to be codified at CEA § 1a(47)(A)(iii)) (emphasis added). Read literally, this provision would include *every* option contract for the purchase or sale of property, including options to purchase real estate and countless other contractual arrangements that are wholly unrelated to the derivatives markets. Title VII of the Dodd-Frank Act is singularly focused on financial derivatives. The Commission should avoid an interpretation of "swap" that contracts this intent.

7 Dodd-Frank Act § 721(a)(21) (to be codified at CEA § 1a(47)(B)(ii)) (emphasis added).

8 *See* 156 Cong. Rec. H5247 (daily ed. Jun. 30, 2010) (statement by Rep. Peterson) ("Excluding physical forward contracts, including book-outs, is consistent with the CFTC's longstanding view that physical forward contracts in which the parties later agree to book-out their delivery obligations for commercial convenience are excluded from its jurisdiction. Nothing in this legislation changes that result with respect to commercial forward contracts.").

physical call options from one or more alternate suppliers. The physical call options give the refinery greater certainty that its supply of crude oil will remain uninterrupted even if its primary supplier is unable to perform. To mitigate this supply risk further, the refinery may purchase additional options from suppliers in different geographic areas or with different grades of product. Such options diversify the refinery's risk management strategy and help to guaranty that even a major disturbance in the crude oil market (*e.g.*, acts of war, natural disasters, etc.) will not materially impact the refinery's supply chain and ability to continue operating as planned. Although these physical options may not be exercised, the refinery depends on the ability to settle each transaction physically whenever the commercial need arises. Hess does not believe that Congress intended to regulate such transactions as swaps.

III. Conclusion

Hess appreciates the opportunity to provide the Commission with its perspective on the Proposed Rule and the impact that an over-broad definition of "swap" may have on commercial entities that rely on physical options to manage their business risk. Hess encourages the Commission to regulate physical options in a way that protects the ability of all market participants to hedge their commercial risk effectively and economically. Hess welcomes the opportunity to discuss these issues further with the Commission and its Staff.

Please contact us at (202) 862-2200 if you have any questions regarding Hess's comments.

Respectfully submitted,

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