

CADWALADER

Cadwalader, Wickersham & Taft LLP
700 Sixth Street, N.W., Washington, DC 20001
Tel +1 202 862 2200 Fax +1 202 862 2400
www.cadwalader.com

New York London Charlotte Washington
Houston Beijing Hong Kong

October 17, 2011

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

Re: Position Limits for Derivatives (RIN 3038-AD15, RIN 3038-AD16)

Dear Mr. Stawick:

We represent many commercial energy and agribusiness companies that have concerns about possible changes reported in the press to the aggregation requirements in the proposed rule establishing position limits for certain physical commodity derivatives that the Commodity Futures Trading Commission is scheduled to vote on tomorrow.¹ As we explain below, those changes, if made, will have significant adverse consequences on commercial users of the commodity futures and swap markets and on market liquidity.

The Proposed Rule contains a provision that would allow a company to disaggregate the positions of an owned non-financial entity provided that it could demonstrate that the futures and swaps positions of the entities are independently managed and controlled (the "Owned Entity Exemption").² The proposed Owned Entity Exemption is similar to exemptions from aggregation granted by futures exchanges pursuant to Commission Regulation 150.5(g) based upon a showing that positions are independently managed and controlled.³ Many commercial companies have built and operated their businesses in reliance upon long-standing exemptions from aggregation for separately managed and controlled positions.

¹ The Commission published the proposed position limit rule in the Federal Register for public comment on January 26, 2011. Position Limits for Derivatives, 76 Fed. Reg. 4752 (Jan. 26, 2011) ("Proposed Rule").

² 76 Fed. Reg. at 4774.

³ 17 C.F.R. § 150.5(g) (2011). We understand that the Commission has granted a limited number of similar exemptions to entities whose agricultural futures positions are independently managed and controlled.

Based on recent press reports, we understand that the Commission is considering deleting the Owned Entity Exemption and replacing it with a provision similar to the current independent account controller (“IAC”) exemption in Commission Regulation 150.3(a)(4) (the “IAC Exemption”).⁴ We also understand that the Commission believes that substituting the IAC exemption for the proposed Owned Entity Exemption will not change the status quo because most companies will be able to disaggregate positions managed by IACs.

A disaggregation provision based on the IAC Exemption will not preserve the status quo. On the contrary, a position limits rule that permits disaggregation solely for IACs would be too narrow and inflexible to accommodate the ways in which many commercial entities are organized and operate. In its current form, the IAC Exemption is available only to “eligible entities.” Commission Regulation 150.1(d) defines “eligible entity” as a commodity pool operator, a commodity trading advisor, a bank or trust company, an insurance company, or their separately organized affiliates.⁵ The term “eligible entity” does not include an entity that is a producer, processor, or commercial user of, or a merchant handling, a physical commodity. Although exchanges currently permit companies to disaggregate the independently managed and controlled positions of their commercial affiliates, these companies would not be eligible to disaggregate under the more restrictive IAC Exemption.

Our clients are concerned that if material changes to the Proposed Rule may be made without adequate notice, the Commission may not fully appreciate the potentially severe adverse impact that those changes will have on commercial entities and the market as a whole. For example:

- **A narrow disaggregation provision would *require* certain commercial entities to coordinate trading with independently managed affiliates.** Some commercial entities share common ownership (greater than 10%) in independently managed and controlled joint ventures. Although co-owners, these companies compete with the joint venture and each other. This competition increases market liquidity while promoting economic efficiency and price discovery. If the Owned Entity Exemption is replaced by the IAC Exemption, the commercial owners and the joint venture would be *required* to coordinate their trading activity by allocating position limits among the aggregated entities and reporting on a consolidated basis even if all of the entities involved are primarily hedgers. Moreover, because of the aggregation requirement, each affiliated entity will hold reportable positions and reach position limits sooner than they otherwise would if permitted to continue to operate on a disaggregated basis.

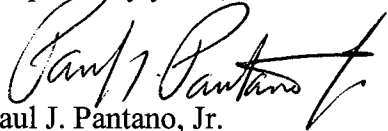
⁴ 17 C.F.R. § 150.3(a)(4) (2011).

⁵ 17 C.F.R. § 150.1(d) (2011).

- **Most holding companies will be subject to aggregation.** Holding companies will be required to aggregate the positions of every company in which they hold an ownership or equity interest of 10% or more, regardless of whether any of the companies is a “financial entity.”
- **An aggregation requirement based on the IAC Exemption would impede mergers and acquisitions involving physical commodity companies.** Currently, one company may acquire another company without any aggregation issues so long as each entity is able to demonstrate independent management and control of their futures and swap positions. However, if disaggregation is permitted only when the conditions in the IAC Exemption are satisfied, a group of commercial companies would be required to aggregate their positions with the target company, even if the activity of each entity is completely separate and independent.

To avoid these and other unintended consequences, we request that the Commission include the Owned Entity Exemption, as proposed, in the final rule. For the Commission’s convenience, we have attached hereto proposed regulation language that would include the Owned Entity Exemption in the final position limit rule. Alternatively, if the Commission declines to adopt the Owned Entity Exemption, we request that the Commission issue an “interim final rule” with a deferred effective date in order to permit further public comment on the aggregation requirement and related exemptions.

Respectfully yours,



Paul J. Pantano, Jr.

cc: Honorable Gary Gensler, Chairman
Honorable Bart Chilton, Commissioner
Honorable Michael Dunn, Commissioner
Honorable Scott O’Malia, Commissioner
Honorable Jill E. Sommers, Commissioner
Daniel Berkovitz, General Counsel
Stephen Sherrod, Acting Deputy Director, Market Surveillance

PROPOSED REGULATORY TEXT

§ 151.7 Aggregation of positions.

(h) Owned non-financial entities. An entity need not aggregate its positions with the positions of one of its owned non-financial entities (*i.e.*, any entity that is not a financial entity and in which another entity directly or indirectly has a 10 percent or greater ownership or equity interest); *provided* that the entity has complied with the requirements of paragraph () of this section, and that the owned nonfinancial entity's trading is independently controlled and managed, indicia of which include:

(1) The entity and its other affiliates have no knowledge of trading decisions by the owned non-financial entity, and the owned non-financial entity has no knowledge of trading decisions by the entity or any of the entity's other affiliates;

(2) The owned non-financial entity's trading decisions are controlled by persons employed exclusively by the owned non-financial entity, who do not in any way share trading control with persons employed by the entity;

(3) The owned non-financial entity maintains and enforces written policies and procedures to preclude the entity or any of its affiliates from having knowledge of, gaining access to, or receiving information or data about its positions, trades or trading strategies, including document routing and other procedures or security arrangements;

(4) The owned non-financial entity maintains a risk management system that is separate from the risk management system of the entity and any of its other affiliates; and

(5) Any other factors the Commission may consider, in its discretion, that indicate that the owned non-financial entity's trading is independently controlled and managed.