October 14, 2011

Hon. Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street NW
Washington, DC 20581

VIA HAND DELIVERY

COMMENT

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OFFICE OF THE SECRETARIAT

RE: *Inclusion of Long-Term Contracts in the Definition of Deliverable Supply for Calculating the Spot-Month Position Limits*

Dear Chairman Gensler:

I. INTRODUCTION.

On behalf of the Working Group of Commercial Energy Firms (the "Working Group")[1] and the Commodity Markets Council ("CMC")[2], (collectively, the "Commercial Alliance"),[3] Hunton & Williams LLP hereby submit the instant letter addressing significant concerns shared by members of the energy and agriculture industries regarding the automatic exclusion of long-term contracts from the Commodity Futures Trading Commission's ("CFTC" or "Commission") calculation of a physical delivery contract's deliverable supply

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1 The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial and residential consumers. Members of the Working Group are energy producers, marketers and utilities.

2 CMC is a trade association bringing together commodity exchanges with their industry counterparts. The activities of our members represent the complete spectrum of commercial users of all futures markets including agriculture. Specifically, our industry member firms are regular users of the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Kansas City Board of Trade, Minneapolis Grain Exchange, and New York Mercantile Exchange. Please note that Hunton & Williams LLP is not counsel to CMC.

3 The Commercial Alliance is a combined effort among commercial agriculture and energy companies to address significant issues under the Commission's rulemakings to implement derivatives reform under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

proposed in the pending notice of proposed rulemaking on position limits for derivatives.[4] Specifically, the proposed automatic exclusion of long-term contracts from the calculation of a physical delivery contract's deliverable supply would severely underestimate deliverable supply and, correspondingly, would artificially reduce the spot-month position limits to the detriment of market liquidity and commercial end-users managing physical commodity risk.

II. COMMENTS OF THE COMMERCIAL ALLIANCE.

A. THE DELIVERABLE SUPPLY CALCULATION SHOULD BE GUIDED BY THE COMMERCIAL AVAILABILITY OF A COMMODITY FOR DELIVERY, NOT THE STRUCTURE OF THE AGREEMENT.

Under new CFTC Rule 151.4(a), spot-month limits would be set at 25% of estimated deliverable supply for the referenced contract's underlying commodity.[5] The estimate submitted by a Designated Contract Market ("DCM") to the CFTC for approval "would include supplies that are available through standard marketing channels at market prices prevailing in the spot month."[6] The Commission has indicated that this estimate would "not include supplies procured at unreasonably high prices or diverted from non-standard locations" or "supply committed for long-term agreements"[7]

The Commission incorrectly assumes in the explanatory text of the proposal that commodities subject to long-term agreements are certain to be consumed and "would not be available to fulfill the delivery obligations arising from current trading."[8] To the contrary, physical market participants that enter into long-term agreements regularly make such supplies available to the market. In certain commodity markets such as crude oil, these long-term agreements represent the vast majority of deliverable supply.

For example, Cushing, OK, the delivery point for crude oil futures contracts in the U.S., is essentially a reseller market and is downstream of first-sales. Almost all initial sales of crude production are made pursuant to long-term agreements, typically from the producer to an intermediary for delivery on the property where it is produced. Intermediaries resell this crude to other intermediaries or directly to end-users. End-users also enter into long-term agreements with producers and intermediaries and then place such procured commodities back into the physical spot markets for economic reasons either by direct sale or through exchange.

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

[5] *Position Limits NOPR* at 4770.

[6] *Id.* at 4758.

[7] *Id.*

[8] *Id.*

Taking into account the role of long-term agreements in the physical commodity supply chain, we urge the Commission to align the spot-month limit formula with the commercial realities of the marketplace by clarifying in the final rule that long-term contracts should not be excluded from the calculation of deliverable supply. In determining the scope of the formula for calculating deliverable supply, the Commission should be guided by the commercial availability of the commodity for delivery rather than the structure of the agreement.

B. TIMING CONCERNS RELATED TO SETTING INITIAL SPOT-MONTH LIMITS.

Under proposed CFTC Rule 151.5(c)(2), DCMs would submit their estimate of deliverable supply by December 31 of each calendar year for each physical delivery referenced contract that is subject to a spot-month position limit.[9] All final CFTC rules promulgated under the Dodd-Frank Act are subject to 60-day period before they become effective. Under the current rulemaking timeline, the process for setting initial spot-month limits under section 151.4(h) appears likely to result in 2012 limits that are set pursuant to the legacy levels in Appendix A to the proposal.[10] For the upcoming year, the Commercial Alliance urges the Commission to update the final rule and require DCMs to submit their estimates of deliverable supply under section 151.4(c)(2) by December 31 of this year in order to produce an accurate estimate of deliverable supply for calculating the initial spot-month limits that would be applicable no earlier than March 2012.[11]

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[9] *Position Limits NOPR* at 4770.

[10] *Id.* at 4776.

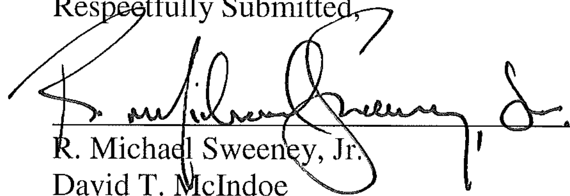
[11] Recognizing the distinct characteristics of individual commodity markets, the Commercial Alliance requests going forward that the Commission adopt a process for determining deliverable supply that is structured in a manner substantially similar to the process proposed in the Working Group comments in the *Position Limits for Derivatives* rulemaking proceeding. *See* Working Group of Commercial Energy Firms, *Position Limits for Derivatives*, Comments, at 19-20 (Mar. 28, 2011).

III. <u>CONCLUSION</u>.

The Commercial Alliance appreciates this opportunity to comment and respectfully requests that the Commission consider the comments set forth herein prior to the adoption of any final rule implementing position limits for derivatives.

If you have any questions please contact Michael Sweeney at (202) 955-1500 or Christine Cochran at (202) 842-0400.

Respectfully Submitted,



R. Michael Sweeney, Jr.
David T. McIndoe
Mark W. Menezes

on behalf of the Commercial Alliance

cc: Commissioner Bart Chilton
Commissioner Michael Dunn
Commissioner Scott D. O'Malia
Commissioner Jill E. Sommers
Rick Shilts, Director, Division of Market Oversight