Commodity Markets Council
1300 L St., N.W. Suite 1020
Washington, DC 20005
Tel 202-842-0400
Fax 202-789-7223
www.commoditymkts.org

February 10, 2014

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: **Position Limits for Derivatives, RIN 3038-AD99; Aggregation of Positions, RIN 3038-AD82**

Dear Ms. Jurgens:

The Commodity Markets Council ("CMC") appreciates the opportunity to submit the following comments to the Commodity Futures Trading Commission (the "CFTC" or "Commission") on its Notice of Proposed Rulemaking entitled "Position Limits for Derivatives" (the "Proposed Rule")[1] regarding speculative position limits on certain contracts in agricultural and exempt commodities. CMC also submits limited comments in respect of the Commission's Notice of Proposed Rulemaking entitled "Aggregation of Positions" (the "Proposed Aggregation Rule").[2]

CMC is a trade association that brings together exchanges and their industry counterparts. Our members include commercial end-users in futures and swaps markets for agriculture, energy, metal and soft commodities. Our industry member firms include regular users and members of such designated contract markets (each, a "DCM") as the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Kansas City Board of Trade, Minneapolis Grain Exchange and the New York Mercantile Exchange. They also include users of swap execution facilities (each, a "SEF"). The businesses of all CMC members depend upon the efficient and competitive functioning of the risk management products traded on DCM, SEFs or over-the-counter ("OTC") markets. As a result, CMC is well positioned to provide consensus views of commercial end-users of derivatives on the impact of the Commission's proposed regulations on their commercial operations. Our comments, however, represent the collective view of CMC's members, including users, intermediaries and exchanges.

1. Federal Position Limits Should Do No Harm to Markets That Work

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") granted the Commission additional authority to prevent "excessive speculation" in Section 4a of the Commodity Exchange Act (the "CEA"), which authorizes the Commission to impose speculative position limits on an aggregate basis for commodity derivatives, including futures contracts, options on futures, and swaps that are economically equivalent to certain referenced futures contracts. This authority, however, was qualified in important ways that the Commission must respect in setting federal position limits.

When excessive speculation leads to distortion in the derivatives or physical markets, CMC believes federal position limits may serve a productive purpose. CMC supports thoughtful, targeted regulations to ensure market-damaging trading does not occur, such as the speculative trading of the Hunt Brothers in 1979-80 in the silver markets, which the Commission sites in the Proposed Rule. The

[1] *Position Limits for Derivatives*, Notice of Proposed Rulemaking, 78 Fed. Reg. 75680 (Dec. 12, 2013).
[2] *Aggregation of Positions*, 78 Fed. Reg. 68,946 (Nov. 15, 2013).

Commission, in prior versions of revised federal position limits, appeared to focus on curbing trading by large institutions such as the "massive passives" often referenced by Commissioner Chilton and other investment vehicles as an alleged contributor to purported artificial prices. The Commission's proposals, however, did not give sufficient consideration to the impact of its rules on physical commodity markets through which commodities are produced, processed, sold, consumed and hedged. In particular, the interests of end-users were largely lost. For example, the fervor to prevent loopholes through which financial firms might engage in speculation removed valuable hedging exemptions upon which commercial firms heavily rely. CMC urges the Commission to reverse this recent trend and give strong consideration to interests of commercial market participants, particularly end-users, when establishing new federal position limits. CMC welcomes the opportunity in this rulemaking process and in all matters before the Commission to inform the Commission about the interests of commercial end-users and to work with the Commission to fashion regulations that support strong derivatives markets that ultimately facilitate efficient physical commodity markets.

The federal position limits regime set out in the Proposed Rule has the potential to detract from the historic versatility of derivatives markets and significantly harm end-users that use these markets to manage risk. CMC members believe the proposed position limits regime will impose current costs in the derivatives markets (and the underlying cash markets) for uncertain benefits in the form of protections against yet unseen harms. This would be unfortunate given that the current federal position limits regime under CFTC Regulation 150 has worked well by allowing markets to operate efficiently. Thus, the Commission should do no harm to end-users when finalizing a rule for new federal position limits.

Accordingly, CMC urges the Commission to adopt a more streamlined approach to federal position limits in adopting a final rule. In large part, this can be obtained by merely updating the current CFTC Regulation 150 with far less drastic measures than appear in the Proposed Rule. The hallmarks of such a streamlined approach could be as follows:

- Amending CFTC Regulation 1.3(z) to conform with the statutory definition of bona fide hedge position;
- Eliminating trade options from federal position limits;
- Engaging in rigorous analysis of the need for additional federal position limits for specific commodity derivatives prior to the imposition of such limits; and
- Removing non-spot-month position limits and all-months-combined limits in favor of accountability levels.

CMC believes that a final federal position limits rule that incorporates such concepts is entirely consistent with CEA Section 4a as amended by the Dodd-Frank Act. To the extent the Commission promulgates a more burdensome final federal position limits rule, it would exceed the mandate of Congress. In doing so, the Commission would inevitably hurt the efficient operations of U.S. derivatives markets and affect the many end-users that come to such markets for legitimate commercial risk management purposes.

The CEA, as amended by the Dodd-Frank Act, requires that any federal position limits regime must consider other regulatory goals under the CEA in addition to curbing excessive speculation. The CEA directs the Commission to balance the following four factors when imposing speculative position limits:

> "(i) to diminish, eliminate, or prevent excessive speculation as described under this section;
> (ii) to deter and prevent market manipulation, squeezes, and corners;
> (iii) to ensure sufficient market liquidity for bona fide hedgers; and
> (iv) to ensure that the price discovery function of the underlying market is not disrupted."[3]

Thus, before imposing any federal position limit, the Commission should present rigorous analysis to demonstrate that these four factors have been balanced. The Proposed Rule did not contain such an

[3] CEA Section 4a(a)(3)(B)

analysis. Moreover, the CEA requires that the Commission, in setting federal position limits, must also promote "sound risk management" and "ensure that trading on foreign boards of trade in the same commodity will be subject to comparable limits and that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade."[4] Again, such analysis did not appear in the Proposed Rule.

For the reasons articulated in this letter, CMC urges the Commission to reconsider and revise its proposal in the areas discussed herein.

2. The Commission Should Not Alter Historically Effective Concepts of Bona Fide Hedge Transactions

The federal position limits regime that appears in the Proposed Rule, if adopted as final, would adversely affect commercial end-users who use derivatives markets for legitimate risk management activities. For example, the Proposed Rule abandons many well-understood concepts contained in the definition of "bona fide hedging transaction" currently found in CFTC Regulation 1.3(z) in favor of a narrower concept of bona fide hedging. Moreover, the proposed rule ignores the plain language of the statutory criteria of bona fide hedge contained in CEA Section 4a(c)(2) by disallowing anticipatory merchandising hedges. Yet, Congress and the CFTC have consistently recognized the importance of protecting risk management activities through reasonable, flexible and effective regulations, and derivatives markets have evolved to provide firms and individuals with effective hedging for risk management. Accordingly, it is crucial for the Commission to avoid any limitation on the ability of end-users to hedge commercial risk in the derivatives markets when adopting new federal position limits. To minimize the impact to commercial market participants, CMC urges the commission to retain many of the time-tested elements of CFTC Regulation 1.3(z) and amend CFTC Regulations 1.3(z) and 150.4 to align with the statutory criteria by, among other things, including merchandising hedges in the definition of "bona fide hedging transaction."

CMC urges the Commission to adopt a view of commercial risk that is consistent with reasonable risk management practices used by commercial firms, particularly by end-users. This approach recognizes that firms hedge many types of risk in addition to price risk. For example, a commercial firm may seek to hedge risks associated with production, quality, politics and laws in foreign jurisdictions, currency, interest rates, counterparty credit, etc. Moreover, price risk is far more complex than just fixed-price risk, but might include volatility and similar non-linear risks associated with prices. A transaction to hedge of any of these risks in connection with a commercial business should receive bona fide hedging treatment.

In adopting a modern and comprehensive view of risk, the Commission should not condition bona fide hedging treatment as available only when risk crystalizes by virtue of a firm holding a physical position or by entering into a contract. Risk is inherent to commercial businesses, and the Commission should empower such firms to manage risk to the fullest extent possible, regardless of whether risk is actually borne at the time it is hedged or reasonably foreseeable. For example, a commercial firm might be a wholesale seller of vegetable oil to a large food company. The food company might procure vegetable oil only on a quarterly basis, calling around to various suppliers seeking price quotations for very large quantities. This procurement cycle forces the supply firms, all of whom are competing for the food company's business, to quote firm prices to the food company, and these prices often must be held out for several days. A seller, exercising reasonable risk management practices, might elect to hedge the price risk (but maybe also quantity, quality, credit or other risks) in connection with making a price offer. Here, hedging actually allows the seller to make the *best* price offer it can to the food company. The central point of this example is that risk presents itself as a function of engaging in a commercial business, and such risk cannot be reduced by reference only to physical or contractual positions held that a firm holds.

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[4] CEA Section 4a(a)(3)(C)

However, if the Commission chooses to rewrite or revise the regulations surrounding bona fide hedging, Appendix I to this letter provides a non-exclusive list of examples of hedging transactions which CMC urges the Commission to ensure are given bona fide hedging treatment in a new federal position limits regime.

- *Anticipatory Hedging Should Not be Restricted, Particularly for Merchandising Activity*

The CEA, which instructs the Commission to define "bona fide hedging transaction," specifically includes three definitional statements in reference to a bona fide hedge position. It states that a bona fide hedge:

> "(i) represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel;
> (ii) is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise; and
> (iii) arises from the potential change in the value of—
> (I) assets that a person owns, produces, manufactures, processes, or ***merchandises*** or ***anticipates*** owning, producing, manufacturing, processing, or ***merchandising***;
> (II) liabilities that a person owns or ***anticipates*** incurring; or
> (III) services that a person provides, purchases, or *anticipates* providing or purchasing."[5] (emphasis added)

The Commission must define a bona fide hedging position in a manner that is consistent with clear Congressional intent in CEA Section 4a(c)(2) and that does not give effect to less than all of the plain terms of such section, including merchandising. This section recognizes that commercial risk management includes anticipatory hedging. Moreover, the statutory provision contemplates anticipatory hedging in connection with merchandising activity. The Dodd-Frank Act did not modify the CEA in such a manner as to carve out hedges in connection with anticipatory merchandising activity.

Merchandising activity is important to the efficient operation of the commercial markets for commodities. Merchandising activity often involves the use of derivatives to lock in a price differential where one leg of the underlying transaction is an un-priced commitment to buy or sell and the offsetting sale is anticipated, but not yet completed. This activity enables producers to place commodities into the value or supply chains and ultimately brings those commodities to consumers with minimal price volatility. Eliminating the ability of commercial entities engaged in merchandizing activity to hedge would damage the efficiency of physical commodity markets. If the Commission is concerned that such market participants might be engaged in manipulative or market-distorting practices, CMC submits that the Dodd-Frank Act armed the Commission with strong enforcement measures that are sufficient to address such concerns. Position limits, again, are designed to prevent excessive speculation, and the Commission has made no convincing arguments that commercial merchandising activity causes or is even connected to excessive speculation.

In the CEA, as amended by the Dodd-Frank Act, Congress made clear that any federal speculative position limits rule should not unduly burden commercial end-users, including merchandisers, who utilize derivatives markets for economically appropriate risk management activities. CMC and its members urge the Commission to ensure that any Final Rule adheres closely to the Congressional intent expressed in the CEA and respects the statutorily-permitted risk management activities in which CMC members and other end-users are engaged.

Among the concerns of CMC is the Commission's interpretation of the phrase "(iii) arises from the potential change in the value of— (I) assets that a person owns, produces…" in CEA Section 4a(c)(2), specifically the reference to "assets." The term "assets" should refer to both (i) physical commodities (*e.g.*, wheat, corn, natural gas) and (ii) fixed assets related to such physical commodities (*e.g.*, grain

[5] CEA Section 4a(c)(2)

elevators, corn crush facilities, and power plants). Commercial firms, under current risk management practices, might use commodity derivatives to hedge the value of assets in both senses. It would be short-sighted and misguided if the Commission were to adopt an interpretation of "assets" that referred only to one type of asset. Such an interpretation would be entirely inconsistent with reasonable risk management practices of commercial firms.

CMC also notes that the Commission recognizes anticipatory hedging in the context of other rules. For example, in the Volcker Rule, the Commission's final rule implementing prohibitions and restrictions on the ability of a banking entity and nonbank financial company to engage in proprietary trading, the Commission permits the trading desk to:

> "establish an anticipatory hedge position before it becomes exposed to a risk that it is highly likely to become exposed to, provided there is a sound risk management rationale for establishing such an anticipatory hedging position . . . . The amount of time that an anticipatory hedge may precede the establishment of the position to be hedged will depend on market factors, such as the liquidity of the hedging position."[6]

Because the Commission recognizes anticipatory hedging for banks and nonbank financial companies supervised by the Board of Governors of the Federal Reserve, the Commission similarly should recognize anticipatory hedging when entities, including marketers, hedge anticipated purchases or sales of a physical commodity.[7]

The Commission also should provide more clarity regarding how anticipatory hedging will work in practice. Example 5 in Appendix C to the Proposed Rule[8] outlines the usage of anticipatory hedging in a soybean crush, but that example raises questions about how proposed regulations, if adopted as final, would impact other commodities where processing does not result in the creation of another traded commodity, such as some byproducts from the processing of corn. More troubling is that while the proposed rule purports to confirm the availability of the longstanding anticipatory soy crush hedge, it removed its utility by adding new restrictions that would deny hedging treatment unless the hedger placed all three legs of the margin crush hedge equally and contemporaneously. The result is that such an interpretation of this rule is of little use, effectively substituting regulatory perception of risk for real economic risk.

- *Economically Appropriate Risk Management Activities*

The Proposed Rule requires a bona fide hedge to be "economically appropriate to the reduction of risk in the conduct and management of a commercial enterprise,"[9] not unlike current CFTC Regulation 1.3(z). CMC recommends the Commission clarify that that such requirement (the "economically appropriate requirement") stand for the proposition that a derivative transaction for which bona fide hedging treatment is sought must be (i) one that a commercial firm in its business judgment deems to be risk reducing, and (ii) the risk reduced must arise in the commercial activities of the firm (the "suggested interpretation").

The Commission did not define what constitutes a "commercial enterprise." CMC believes a definition is not necessary should the Commission adopt the suggested interpretation of the economically appropriate requirement. The central concept is that the derivatives transaction occurs in connection a firm's commercial activity. In the alternative, CMC urges the Commission to clarify that each market participant be allowed to define what constitutes a "commercial enterprise" so as to match the way in

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[6] *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, Final Rule, p. 297 of draft text.
[7] In addition, the Commission should clarify that commercial producers and users should be permitted to manage legitimate business risks surrounding unfilled storage capacity.
[8] Proposed Rule at 75836.
[9] Proposed Rule at 75823.

which it manages risk. Firms might manage risk at an entity level[10] or a smaller segment of its business (or both). The Commission should avoid a concept of "commercial enterprise" that effectively overrides how commercial firms manage risk.

CMC is quite concerned that the Commission, through the economically appropriate test, has imposed a new test for identifying a bona fide hedge. The Commission, in the preamble to the Proposed Rule, states:

> "In order for a position to be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, the enterprise generally should take into account all inventory or products that the enterprise owns or controls, or has contracted for purchase or sale at a fixed price."[11]

This language suggests that a bona fide hedge only exists when the net price risk in some defined set is reduced. This test is misguided and is not in line with widely-used risk management practices. Companies look at risk in many ways, not limited to price risk, as mentioned above. The most appropriate way to deem a derivatives transaction as "economically appropriate" is whether a commercial firm has a risk abated by the transaction, and such risk arose in its commercial business. Linking the availability of bona fide hedging treatment to a net reduction in a portfolio of risks is not consistent with how commercial firms commonly address risk. Moreover, individual firms identify which risks they want to accept. A transaction that may increase the risks inherent in one side of the business (*e.g.*, sales) might serve legitimate business purposes. Thus, to impose a "net price risk" formula for purposes of bona fide hedging effectively replaces a commercial firm's business judgment with regulatory prescription.

- *Gross and Net Hedging*

The Commission uses concepts of "gross hedging" and "net hedging" in its discussion of the economically appropriate requirement. However, these terms are not separately defined and the context in which they appear does not fully inform their meaning. CMC understands gross hedging to be the practice of separately hedging each of two or more related positions. For example, a firm may have three purchase contracts for wheat: one from Russia, the second from Brazil and the third from Australia, and such firm may have one sale contract for wheat, perhaps for delivery in China. Under a gross hedging approach, the firm might enter into three short derivatives trades, each to hedge a specific purchase contract, and one long derivatives change to hedge the sale contract. Net hedging happens when that firm nets its purchase and sale contracts to a net long position of two contracts, and then offsets that risk by entering into two short derivatives transactions. CMC asks the CFTC to (i) remove any references in the Proposed Rule that limit the ability of end-users to utilize both "gross hedging" and "net hedging" concepts and (ii) affirm that each of these methods entail derivatives that would be eligible for bona fide hedging treatment. Additionally, when utilizing gross hedging, firms should have the flexibility to hedge either the gross long or the gross short when this is the most economically appropriate risk management position.

- *Portfolio Hedging*

The final federal position limits rule should explicitly allow for a bona fide hedging position to be entered into in connection with a portfolio hedging strategy. The Proposed Rule was not explicit on this point, perhaps as the result of simplified examples, which imply a view that bona fide hedging transactions can only be done on a one-to-one basis. That is, that a market participant must be able to trace the offsetting effect of a derivative contract to some specific exposure. In contrast, CMC

[10] The economically appropriate requirements becomes even more problematic under the aggregation rules, which could force the consideration of positions of business units that are operationally separate with no coordinated control or information sharing.
[11] Proposed Rule at 75709.

members must retain the ability to characterize derivatives as bona fide hedging positions when they offset risk that is managed on a portfolio basis by a commercial market participant.

Many large commercial firms, including some CMC members, rely upon portfolio hedging to manage legitimate business risks due to the large number and volume of commercial transactions which are hedged. These firms often utilize centralized hedging desks to aggregate risk from multiple assets and/or divisions. CMC members who use centralized hedging desks do so because those members find central hedging to be an efficient way to manage their risks and because, in some cases, limited liquidity would make it inefficient for a firm to hedge individual transactions. For these firms, "one-to-one" hedging, wherein a hedging position can be tied to a specific physical position or asset, is not possible. Explicit recognition by the CFTC that the bona fide hedging definition includes portfolio hedging is particularly important to commercial end-users who use central hedging desk.

- *Non-Enumerated Hedges Should be Effected by Notice Without an Approval Process*

One of the efficient market-enabling features of CFTC Regulation 1.3(z) is the availability of non-enumerated bona fide hedges. The availability of such hedges are crucial to commercial firms, who often utilize legitimate commercial hedging strategies that may not fall within any of the narrow enumerated hedge categories. The non-enumerated hedge category allows commercial firms to engage in transactions in real time without the risk of the market moving against them while they put hedges in place. Non-enumerated hedges have also been critical to allow markets to evolve and to permit market participants to develop new hedging strategies. CMC requests that the Commission retain the non-enumerated hedge concept currently codified in CFTC Regulation 1.3(z). The existing rules delegate the authority to grant non-enumerated hedge exemptions to CFTC Staff and provide specific timeframes for a response, both of which encourage timely responses to non-enumerated hedge filings.

Under the Proposed Rule, if the CFTC does not recognize a hedge position as an enumerated hedge, the position does not qualify as a bona fide hedging position. Market participants can petition the Commission, pursuant to CEA Section 4a(a)(7), to issue a rule, regulation or order, or to expand the list of enumerated positions to include the position described in the petition. However, in contrast to the Commission's existing procedures for granting non-enumerated hedge exemptions, the proposed process to file for exemptive relief is a very formal and lengthy process and the Proposed Rule does not specify a timeframe within which the Commission must respond to a request.

The Proposed Rule would also permit market participants to seek interpretive or no action relief from CFTC staff under CFTC Regulation 140.99. Although it is not entirely clear, CMC is concerned that CFTC Regulation 140.99 may only give CFTC staff the discretion to say whether or not a transaction fits within the enumerated hedging categories and may not give CFTC staff the authority to treat as a bona fide hedging transaction a transaction that CFTC staff believes falls outside of the enumerated hedging categories. The Proposed Rule also does not include a timeframe for CFTC staff to respond to such a request. CMC understands that CFTC Staff are concerned about the timeframes to review a non-enumerated hedge filing under current CFTC Regulation 1.47, which provides a 30-day review period for initial filings and a 10-day review period for supplemental filings. But rather than abandon the current process to recognize non-enumerated hedges due to concerns about the timing for review of novel questions, the Commission should retain the existing process and give CFTC staff authority to extend the response period when confronted with novel and complex notice filings.

The procedures in the Proposed Rule will render ineffective the non-enumerated hedging concept. Moreover, it is uncertain how the Commission might handle a large volume of petitions for non-enumerated hedging exemptions, interpretive guidance and no action relief. There is also uncertainty whether the CFTC would grant a non-enumerated hedge petition without limitation or qualifications that adversely affect the utility of the hedge or might limit the application to a single transaction. In addition, there is an open question about the ability of a non-petitioning market participant to rely on any non-enumerated hedge that the Commission may give to a third party. All the while, the market

will continue moving. So, it is possible that a hedge (or even the entire transaction) could become uneconomic while the petition process runs its course.[12] Dilatory responses by the CFTC to non-enumerated bona fide hedging petitions by commercial participants could even put these commercial end-users at a disadvantage to non-commercial participants.

- *Cross-Hedging*

Cross-hedging is particularly important for commodities which may be processed or transformed into products which may not be traded commodities. For example, the ability to hedge electricity with natural gas is a well-recognized reasonable cross hedge in which many commercial firms engage without speculative purposes. Electricity is a commodity that cannot be readily stored and for which many related derivatives contracts have little liquidity, particularly in long-dated out months and at lower volume delivery points. In contrast, natural gas can be stored and related derivatives contracts are often liquid in long-dated out months. Moreover, given that many power plants use natural gas as the primary fuel to generate electricity, the relationship between these commodities is well established (in fact, they are often used together in the form of heat rate transactions to hedge the profitability of a power plant). A cross-hedging rule that does not recognize such transactions as bona fide hedging transactions hampers the ability of commercial firms in the power industry to manage risk.

The cross-hedge concept in proposed CFTC Regulation 150.1 requires, among other things, that price movements in a hedging instrument (or the commodity underlying the hedging instrument) be "substantially related" to price movements in the hedged position.[13] CMC suggests that commercial firms be granted the discretion to determine what relationships between two positions are correlated sufficiently to be considered "substantially related." The Commission should not advance a bright-line test in this respect. The decision to use a cross-hedge is multifactored, and commercial businesses have a natural profit incentive to achieve as great a correlation as possible. However, a set degree of correlation is not always achievable, and sometimes risk managers are limited in their selection to what is available. Specifically, CMC objects to the usage of a 0.8 correlation coefficient to qualify a contract for utilization as a cross hedge. In even a cursory review, examples can be found in which a cross-hedge of two contracts with the same underlying commodity would not achieve a 0.8 correlation, such as corn or natural gas contracts delivered in two different locations. Additionally, end-users may need to utilize cross-hedging in cases where seasonality impacts the correlation between the two commodities. CMC members believe that a position limits regime where risk managers can freely select their cross-hedges, report them as such and stand ready to explain them to the Commission if necessary is the proper regulatory design.

Additionally, CMC urges the Commission not to impose an arbitrary deadline upon which market participants engaged in cross hedging must exit their hedges in the spot month or near month. DCMs should be permitted to set restrictions on a contract-by-contract basis, recognizing the unique characteristics of each individual commodity and contract, and the need for commercial end-users to continue to utilize cross-commodity hedges in a specific market.

3. Trade Options Should Not be Subject to Position Limits

In the Proposed Rule, "trade options" are included as physically-settled referenced contracts for the purposes of position limits.[14] CMC urges the Commission not to categorize trade options as referenced contracts subject to position limits. Physical options, including physical forward transactions with embedded volumetric optionality, are an important tool in physical commodity markets. Trade options

[12] Even more concerning is the possibility that a hedging transaction or strategy may become uneconomic or unavailable simply because of the uncertainty created by a delayed response by the Commission or its staff.
[13] Proposed Rule at 75824.
[14] Proposed Rule at 75711.

may be used to manage, among other things, supply chain risk, price risk or both.[15] Subjecting these products to federal position limits could severely harm the efficient operation of physical commodity markets and increase costs for end-users.

Importantly, in order for a physical commodity option to qualify as a trade option, the offeree must "be a producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity option transaction, or the products or byproducts thereof, and such offeree *is offered or entering into the commodity option transaction solely for purposes related to its business as such*."[16] In other words, because a trade option must be related to the offeree's commercial business, it cannot be a speculative derivative and certainly cannot give rise to excessive speculation.

The primary purpose of trade options is to ensure that commercial market participants have access to physical commodities. The Commission noted in its Interim Rule on the Trade Option Exemption[17] that trade options are "commonly used as hedging instruments or in connection with some commercial function, [and will] normally qualify as hedges, exempt from the speculative position limit rules."[18] However, in the vast majority of cases, trade options will not qualify as bona fide hedging transactions as defined in the Proposed Rule. For example, it is not clear whether a physical option qualifies as a temporary substitute for a transaction in the physical marketing channel because the physical option is a transaction to be taken in the physical marketing channel (thus, not a substitute). Moreover, many trade options have a floating strike price, and would not offset price risk incidental to a commercial operation as required under the proposed bona fide hedging definition. In addition, these physical options are more like physical forward and spot contracts, which are not subject to speculative position limits, than they are like Referenced Contracts. For example, market participants use trade options to source physical supply in the same manner as a forward contract. As a result, the trade option represents the physical supply arrangement that a market participant needs to hedge with derivatives, as opposed to the trade option performing the function of a derivative.

Further, several of the proposed enumerated bona fide hedging categories would not permit a market participant to carry the trade option into the spot month. This is highly problematic for commercial firms who frequently rely on such trade options to meet supply chain needs on a daily basis. While the impact of the Proposed Rule is that such trade options would merely lose their bona fide hedging status, this ignores the fact that, in doing so, a commercial end user might be forced into a position limit violation even though its physical option positions are *not* speculative. The spot month concept, though relevant to physical futures, does not make commercial sense when discussing trade options. Further, the use of long term deals which can extend five to ten years into the future would make it difficult for a firm with such deals to stay below the non-spot-month position limits if these deals are not considered hedging.

Trade options do not trade like physical futures and cannot simply be traded out of or unwound prior to the spot month. In the spot month, a trade option that does not qualify as a "bona fide hedging position" could only be offset with another physical position to bring the net position within the applicable position limit. Taking on a physical position in order to offset a trade option for position

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[15] The issues associated with trade options that are used to manage supply risk are even more confounding for physical transactions with volumetric optionality that are regulated as trade options. Embedded volumetric optionality most often exists in physical agreements to facilitate efficient contracting and operational planning in physical markets. Such agreements allow market participants to secure commercial terms for supply and demand of a volumetric range for what is an unknown future requirement. Given the uncertainty around the application of the CFTC's guidance for forward transactions with embedded volumetric optionality, many market participants have conservatively treated such transactions as trade options. Position limits will very likely impede the use of such agreements, which will lead to contracting inefficiencies, subject firms to spot physical supply volatility, and ultimately increase costs for end-users of physical commodities.

[16] CFTC Interim Final Rule 32.3(a)(2) (emphasis added).

[17] *Commodity Options*, Final Rule and Interim Final Rule, 77 Fed. Reg. 25320 (Apr. 27, 2012).

[18] Id. at 25328.

limit purposes could introduce new risks to the market participant and would undermine the entire purpose the market participant entered into a trade option in the first place. Such a result would be extremely disruptive.

The burden on market participants associated with speculative position limits on trade options would be substantial. Market participants would be required, for the first time, to track trade options separately from spot and forward contracts, develop systems to calculate the futures contract equivalents for these physical-delivery agreements, and, ultimately, monitor trade option positions for compliance with applicable limits. CMC is unclear as to what purpose the Commission is trying to achieve or what market-disrupting activity the Commission is intending to prevent with the imposition of these requirements, and would appreciate clarification from the Commission. In addition, given the facts and circumstances analysis associated with the forward contract exclusion, there is significant uncertainty regarding the distinction between forward contracts and trade options. For a single transaction, one market participant may categorize the transaction as a forward contract while another may categorize the transaction as a trade option.

Additionally, data on trade options was not considered by the CFTC when setting levels for non-spot-month position limits. If the Commission determines to include trade options under speculative position limits, this lack of relevant data could adversely impact CMC members who hold positions in both physically-settled contracts and trade options. If the Commission adopts this course, CMC urges the limits be adjusted based on all relevant data, including that of trade options.

4. Curbing Excessive Speculation, but Not Speculation in the Ordinary Course

Section 4a of the CEA, as amended by the Dodd-Frank Act, requires the Commission find "excessive speculation" has occurred and that such excessive speculation has resulted in "unwarranted and unreasonable price fluctuations"[19] before imposing position limits. The necessity for the imposition of new federal imposed position limits has not been clearly demonstrated as statutorily required. As former Chairman Gensler and the Commission have publicly acknowledged, studies regarding the impact of speculation on volatility have come back with mixed results and an abundance of research indicates there is no consensus that excessive speculation and price volatility are connected. At no time has Commission included any evidence of prevalent excessive speculation in today's derivatives markets. Thus, it is inappropriate for the Commission to actually impose new federal regulations regarding position limits above and beyond those that already exist. Simply put, the Commission has not made the case for additional position limits legally or academically.

The newly proposed federal position limits might also cause a damaging loss of market liquidity. Specifically, the Proposed Rule arguably constrains speculative trading to an unnecessary extent. While CMC members primarily use the derivatives markets for hedging purposes, speculators are an important source of liquidity necessary to support such hedging activity. Speculation by itself is not manipulation, nor is it an inappropriate practice. Indeed, it is an essential component of any derivatives market, providing the liquidity necessary to ensure the price discovery and risk management functions are achieved. This concept is enshrined in the CEA itself. CEA Section 3(a) contemplates that derivatives markets are forums for the "managing and *assuming* price risks, discovering prices . . . through trading in *liquid* . . . trading facilities."(emphasis added) Thus, Congress recognized that speculators serve the public interest by assuming risks and providing necessary market liquidity. Imposing unnecessary constraints on speculation through ill-conceived federal position limits can only damage derivatives markets and harm their participants, including hedging end-users.

Concerns over potential harm from "excessive speculation" are better dealt with by self-regulatory organizations (each, an "SRO") through existing market surveillance programs on a contract by contract basis. SROs, in coordination with the CFTC, have developed an expertise in maintaining orderly

[19] CEA Section 4a(a)(1)

markets, including setting appropriate reporting levels, position limits and accountability levels relative to energy, metals and agricultural markets. Congress explicitly recognized this expertise in Section 735 of the Dodd-Frank Act which states, "to reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), the board of trade shall adopt for each contract of the board of trade, as is necessary and appropriate, position limitation or position accountability for speculators."[20] This system provides the flexibility necessary to prevent market-disrupting speculation when necessary and appropriate on a contract-by-contract basis while preserving transparent, liquid and orderly markets for risk management and price discovery.

Though the CFTC has endeavored to collect market data regarding the size of various commodity markets, such data as presented in the Proposed Rule do not include the full scope of transactions that would be included under the federal position limits, and the Commission is thus unable to make informed necessity determinations for the imposition of speculative position limits. For example, such data does not include volumes that people have traded in OTC transactions. Thus, the CMC urges the Commission to defer imposition of any new position limits regime until it has received and thoroughly analyzed data representing the full scope of contracts and transactions it wishes to capture with these position limits, and provided that analysis to the public for market participants to review and understand.

5. The Proposed Position Limits

The Commission should build upon the existing federal position limits regime and avoid any wholesale redesign of the current regime. As stated above, exchanges, in coordination with the Commission, have developed an expertise in maintaining orderly markets with the flexibility necessary to prevent market-disrupting speculation while preserving transparent and liquid markets. In crafting a new federal position limits regime, CMC urges the Commission to take the following items into consideration:

- *Use of Accountability Levels in lieu of Non-Spot-Month Position Limits*

As discussed in the section below, CMC respectfully submits that the Commission has not established a sufficient empirical rational for imposing non-spot-month position limits. However, to the extent that the Commission is determined to address positions outside of the spot-month, CMC recommends that the Commission adopt federal position accountability levels as a more flexible and less burdensome alternative to hard non-spot-month position limits.

DCMs have been and continue to be strong proponents of accountability. Market participants, in turn, have operated their businesses and conducted their trading activities in compliance with exchange position accountability frameworks. During this period, the markets generally have remained liquid, provided efficient price discovery, and remained free from any significant disruption.

CMC supports the concept of federal position accountability levels where the CFTC has the opportunity to gather additional information about the trading activity and strategy of any party who holds positions in excess of these levels in a particular market, as the Commission has previously supported. Federal accountability levels would enable the Commission, in cooperation with existing and enhanced exchange market surveillance programs, to determine on a case-by-case basis whether a large position may lead to excessive speculation or a realistic threat of price manipulation. As a result, position accountability levels would provide the Commission with an effective and flexible tool to monitor for, and prevent, excessive speculation and to promote safety and stability in commodity markets.

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[20] CEA Section 5(d)(5)(A)

- *Non-Spot-Month Position Limits are Arbitrarily Restrictive*

CFTC Regulation 150.2(e)(4), as revised in the Proposed Rule, uses an "open interest formula" to determine both single-month and all-months-combined position limits ("non-spot-month position limits") regardless of the characteristics of the market. These hard non-spot-month position limits on Referenced Contracts are based on 10% of open interest for the first 25,000 contracts and 2.5% of open interest thereafter (the "10/2.5 Formula").[21]

The Commission first proposed the open interest formula in 1992 as the basis for new speculative position limit levels for "legacy" agricultural commodities subject to federal speculative position limits.[22] Crucially, it did not use the formula to automatically adjust limits for these commodities. In the same 1992 rulemaking, the Commission stated that the "fundamental tenet in the Commission's setting of speculative position limits is that such limits must 'be based upon the individual characteristics of a specific contract market.'"[23] The Commission also noted that "the limits which are appropriate for certain types of commodities, such as agricultural commodities, may [not] be appropriate for other tangible or intangible commodities."[24] The Commission suggested different limits might be appropriate for non-agricultural commodities because of the "depth of the underlying cash market and ease of arbitrage [that] differ from agricultural markets."[25]

Notwithstanding the fact that the Commission did not find the open interest formula appropriate for 19 of 28 referenced contract commodities in 1992, the Commission now proposes to apply this formula to all 28 referenced contract commodities, and to approximately 500 fundamentally varied futures, options, and listed swaps, and an unknown number of OTC swaps, regardless of the characteristics of each of the respective markets. The Proposed Rule does not attempt to explain how the limits that result from the open interest have moved over the past 21 years from "not being appropriate" to "appropriate" for these 19 referenced contract commodities and now several more.

Storable commodity markets are fundamentally different than continuously produced non-storable commodities. In markets in which the commodity cannot be stored and carried from one delivery period to the next, deliverable supplies in subsequent expiration months are independent from the previous expiration months. Therefore, a reduction in the deliverable supply for the current delivery period does not lead to a reduction of deliverable supply for all subsequent delivery periods, and the prices of related futures contracts are not linked across months by the cost of storage. Therefore, a change in the futures price for one contract month does not necessarily lead to similar changes in the price of all subsequent contract months within a relevant period. Dairy markets are a primary example of this type of market. In these markets, the commodity is sold upon its production without ability for significant storage of the commodity, and most hedging is done through the trading of strips. For these reasons, the Commission deemed the all-months-combined limits unnecessary and found that the benefits of such limits did not outweigh the likely cost of eroding speculative volume and liquidity and the disruption in the efficient functioning of the non-storable commodity futures markets.

The Commission's inflexible non-spot-month position limits have no apparent relationship to deterring excessive speculation or manipulation. As demonstrated with non-storable commodities, the limits the Commission proposes would have widely different effects on futures for different commodities. Table 11 within the Proposed Rule shows that, based on data from 2011-2012, a total of 32 unique persons in CME Class III Milk, CME Feeder Cattle, CME Live Cattle and CME Lean Hogs would have been over the all-months-combined limits that the Commission proposes for these products. This data indicates that imposing all-months-combined limits in these non-storable commodity markets would have a significant

[21] Proposed Rule at 75827.
[22] *Revision of Federal Speculative Position Limits*, 57 Fed. Reg. 12,766 (Apr. 13, 1992).
[23] Id. at 12,770, citing 52 Fed. Reg. at 6815.
[24] Id.
[25] Id. at fn. 14.

negative impact on the liquidity in these markets.[26] In contrast, according to the Commission's analysis, no enterprises would have been affected in NYMEX Henry Hub Natural Gas. The Commission provides no explanation or observations from these disparate impacts. In the absence of additional insight from the Commission, Table 11 indicates that the impact of the Commission's non-spot-month position limits is random and bears no logical relationship to the prevention of excessive speculation or manipulation.

The imposition of all-months-combined limits may have a negative impact on liquidity, particularly for months that are further out from the spot month. This loss of liquidity is simply a function of open interest increasing in the near months effectively crowding out positions held in the far months.

If the Commission nevertheless determines to impose non-spot-month position limits based on the 10/2.5 Formula, it should include the open interest of all of the Referenced Contracts when calculating non-spot-month position limits. Otherwise, any non-spot-month position limits adopted by the Commission would not accurately represent the expected results of applying the 10/2.5 Formula to all open interest, but rather would reflect a calculation based on an incomplete and, therefore, inaccurate subset of those data. The non-spot-month position limits necessarily would then be overly restrictive under the Commission's own formula – a result that the Commission is required by statute to avoid.

The Proposed Rule only considers open interest from calendar years 2011 to 2012 for futures contracts, options on futures contracts, and significant price discovery contracts. Significantly, the Proposed Rule ignores the volume of OTC transactions in Referenced Contracts for which the Commission has collected detailed information. The Commission declined to rely on open interest data from the Part 20 swaps large-trader reporting data, apparently because of some unspecified inaccuracies in the data. In addition, the Commission declined to rely on swap data reported to SDRs in accordance with CFTC Regulations 43, 45 and 46. Further, Commission-collected data do not include information about trade options, despite inclusion of Trade Options as physically-settled referenced contracts. It is also unclear what information obtained by the Commission in connection with various special calls is reflected in the data. If all the aforementioned transactions were included in the open interest data, then the open interest figures likely would increase significantly.

The Commission should not establish non-spot-month position limits on all Referenced Contracts based on an incomplete set of data. Under vacated CFTC Regulation 151, the Commission refrained from setting non-spot-month position limits until it had collected 12 months of open interest for futures, options on futures, and "all of a Referenced Contracts month-end open swaps positions, considering open positions attributed to both cleared and uncleared swaps."[27] The Commission should adopt this same approach when issuing a final federal position limits rule and wait to establish non-spot-month position limits until after it has open interest data for the entire market.

- *Calculation of Deliverable Supply for Spot-Month Position Limits*

The Proposed Rule establishes separate spot-month position limits for physical-delivery Referenced Contracts and cash-settled Referenced Contracts. These limits are based on 25% of the estimated deliverable supply of the commodities that underlie the Referenced Contracts. For the initial limits, the Commission proposes to rely upon the existing spot-month position limits in place across the DCMs that list the twenty-eight Referenced Contracts. However, the Commission also requested comment on the alternative estimates of deliverable supply submitted by the CME Group.

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[26] A similar result would occur in COMEX Copper referenced contracts, where 16 unique enterprises would have been over the Commission's proposed speculative position limit levels based on their positions during 2011-2012.

[27] *Position Limits for Futures and Swaps*, Final Rule and Interim Final Rule, 76 Fed. Reg. 71626 (Nov. 18, 2011) at 71687.

CMC generally supports the CME Group alternative estimates of deliverable supply. Any new federal position limits regime should be based upon current deliverable supply analysis upon implementation rather than using existing DCM limits. The Commission has historically relied upon the exchanges' expertise regarding estimates of deliverable supply and should continue to follow its practice of relying upon the exchanges' expertise in estimating deliverable supply for the purposes of setting spot-month position limits.

If the Commission believes that 25% of estimated deliverable supply is an appropriate formula to establish spot-month position limits, then the Commission should rely on the most current levels of estimated deliverable supply available. The large disparity between historic estimates and the CME Group alternative estimates demonstrates that the existing estimates need to be updated and that the CFTC should validate and rely on the CME Group alternative estimates. Any position limits based on outdated and inaccurate estimates would likely be overly restrictive and may limit the liquidity available to hedgers that do not hold bona fide hedge positions. After implementation, updates to deliverable supply analysis should be conducted periodically to ensure the limits reflect changes in market dynamics.

CMC further submits that deliverable supply should include supply that is subject to long-term supply contracts, as the market structure for many physical commodities makes certain amounts of volume subject to long-term supply arrangements to the spot markets. This would be included as a part of speculative position limits, and should be included in any Commission calculation of deliverable supply.

Furthermore, as provided for in the Proposed Rule, CMC supports the ability of DCMs or SEFs to set their own position limits on a contract-by-contract basis at lower levels if they deemed it appropriate, whether or not based upon deliverable supply information.

- *Determinations for Referenced Contracts*

The Commission should provide a definitive list of referenced contracts that are listed on any DCM or SEF as part of the final federal position limits rule. This list should be updated in connection with any exchange applying to list a new contract. This list would add certainty to the derivatives markets.

The Proposed Rule provides that contracts that are "directly or indirectly linked" to core referenced futures contracts are referenced contracts.[28] Unfortunately, the concept of "indirectly linked" is not clear. A wide range of contracts that are only tangentially related to a core referenced futures contract could be treated as referenced contracts by some market participants and not others. Neither side could be certain of their determination until CFTC brings an enforcement action against some market participant. Such a result might impede commercial users using derivatives markets for risk management as such tenuously-related contracts would count against the position limit. For example, in energy markets prices of physical commodities at certain delivery locations are calculated based on a price or index published by a price reporting agency, but such index may be partially formed on other contracts that are priced in part upon a core referenced futures contracts. These common physical contracts are constrained by the physical markets, but their indirect price-reference could bring such contracts an additional constraint – federal speculative position limits.

- *SEF Requirement to Set Position Limits*

CMC is concerned that many SEFs may not be able to set informed position limits. Traditionally, DCMs have been able to set reasonable and informed limits due to their link with the clearinghouse. The structure of a SEF breaks the link between the SEF and the clearinghouse. Thus, the SEF may not have the ability to set reasonable and informed position limits. Further, in the context of an uncleared transaction (*e.g.* commodity swaps executed via a voice broker), a SEF cannot know a market participant's position in the referenced contract executed on or pursuant to the rules of the SEF

[28] Proposed Rule at 75825.

because the market participant may offset the transaction with another uncleared transaction not executed on or pursuant to the rules of the SEF. There is no way for a SEF to obtain or maintain such information about all market participants, particularly when market participants use introducing brokers and have not direct relationship with the SEF.

- *Wheat Equivalence Determinations*

CMC urges the Commission in setting the new limits to maintain equality between three U.S. Wheat markets, CBOT, KCBT and MGEX. Currently, they each have the same spot month limit of 600 contracts and the same single-month and all-months-combined limit of 12,000 contracts. However, the proposed regulations would end the limit equality among these three markets. Different limits for the same type (but not necessarily variety) of commodity could dramatically impact the growth or potential for risk mitigating strategies between the contract markets. In the case of wheat, this is particularly critical given the nature of the three differing varieties. Having three varieties provides not only additional opportunities for market participants to reduce risk through spread trades, but also provides opportunity for hedging and risk management by commercial participants between markets in response to domestic or global economic factors that could result in varying impacts on differing varieties of wheat.

- *Sugar No. 11 Should not be Subject to Federal Position Limits*

CMC believes that Sugar No. 11 should not be subject to federal position limits, and that the current position accountability limits regime should remain in effect. Sugar No. 11 is the international benchmark for raw sugar trading. It prices the delivery of raw cane sugar, free-on-board the receiver's vessel to a port within the country of origin of the sugar or in the case of landlocked countries, at a berth or anchorage in the customary port of export. The Sugar No. 11 contract is not imported into the United States due to the restrictions of the U.S. sugar support program, and therefore is not stored in the United States. This sugar is also not transported within the United States. Thus, the foreign raw cane sugar priced by the Sugar No. 11 contract places no burden on interstate commerce because it never enters into interstate commerce, and does not meet the Commission's own standards for inclusion in the federal position limits regime. In a worst-case scenario, position limits could result in uneconomic volumes at international delivery points undermining the utility of the contract for commercial participants. For these reasons, and as further explained in the July 15, 2013 letter to the Commission from ICE Futures US and its World Sugar Committee, the Commission should not include the Sugar No. 11 contract as a referenced contract or otherwise subject it to federal position limits.

- *Spread Exemption as Applied to Certain Soft Commodities*

Due to the lack of fungibility of certain soft commodities, including coffee, cocoa, and frozen concentrated orange juice, inventories of various categories vary widely in terms of marketability over time in spite of a well-defined contract specification. The spread exemption allows for effective competition for the ownership of certified inventories. This in turn helps to maintain a close relationship between the futures contract and the underlying physical commodity. The same competition for ownership of certified inventories helps to contain effective costs of carry facing long holders of the physical commodity, keeping the cost of hedging by end-users down. By the same token, spot prices for the physical commodity are not artificially depressed, preserving value for small farmers around the world who lack the capital to effectively access futures markets for hedging. The elimination of the spread exemption would lead to a gradual depletion of certified inventories due to a lack of incentive to certify fresh supplies in light of artificially inflated returns on carry at origin, leading to a likely inflation of the nearby basis and the risk of exacerbated volatility in a supply disruption due to lack of certified stocks.

6. Aggregation Policy

CMC supports many of the exemptions contained within the Proposed Aggregation Rule, especially those provisions which allow entities with up to 50% joint ownership but under independent control to be exempt from aggregation subject to certain conditions. However, CMC has certain concerns with the Proposed Aggregation Rule as outlined below.

- *Aggregation when Two Parties are "Acting Together Pursuant to an Express Agreement"*

Example 7 of Appendix C within the Proposed Rule outlines a case in which a "sovereign and a farmer acting together pursuant to an express agreement" triggers position limits aggregation.[29] This example troubles CMC members, as it describes an option transaction between two counterparties who, under the facts presented, are not obviously acting in concert pursuant to any express or implied agreement. Under the logic of this example, merely becoming a counterparty to a contract results in two parties "acting together pursuant to an express agreement," thus forcing aggregation between them. CMC believes that the CFTC should delete Example 7. At best, the Example creates confusion and ambiguity and, at worst, the example represents a drastic departure from the general market understanding of what it means to "act together pursuant to an express agreement."

- *Information Sharing*

CMC understands the information sharing restrictions that are conditions to not aggregating the positions of two affiliates. However, not all information sharing should be prohibited. In particular, CMC believes that information sharing for risk management purposes should be exempt from these restrictions. In general, the Commission should provide explicit safe harbors for certain information sharing within any final rule for the aggregation of positions.

- *Owned Entity and Independent Account Controller Exemptions*

The focus of the CEA is, and the focus of the Commission's aggregation rules must be, the common trading control of trading accounts and ownership interests in trading accounts. The Commission staff should not conflate (i) ownership interest in accounts with (ii) ownership interest in legal entities. Legal affiliation has been an indicium but not necessarily sufficient for position aggregation. This misunderstanding underlays the whole of the Proposed Aggregation Rule. In essence, the Proposed Aggregation Rule seeks to validate and give the force of law to an un-vetted standard that is unconvincingly represented as the Commission's long-standing requirement. The Commission should not, by this shaky representation, discount criticisms and concerns raised by market participants, and particularly end-users, about the practical challenges of complying with a default requirement for aggregation that is based solely on corporate ownership.

The Proposed Aggregation Rule would require investors to aggregate positions of owned entities in which they have a greater than 10% ownership interest, subject to two exemptions: one that applies at or below 50% ownership that requires a demonstration that the two entities are independently controlled and a second that applies above 50% ownership which requires Commission approval of an application that certifies the two entities are not included in the same consolidated financial statement and a certification by the owning entity that the owned entity will not exceed 20% of any position limit. Relief in instances where ownership is more than 50% is extraordinarily difficult to obtain.

In contrast, the CEA and Commission rules require aggregation of another company's positions (owned entity or not owned entity) based on the existence of common trading control and ownership interests in accounts. In order to comply with the Commission's proposal with regard to entities where ownership is more than 10%, a commercial enterprise with multiple affiliates, each of whose

[29] Proposed Rule at 75837.

derivatives hedging and trading is controlled independently, may have to centralize risk management and trading operations. For many commercial enterprises this aggregation would be costly and represent a radical shift and hindrance on these firms' prerogative to determine the appropriate risk management program for each of their business lines independently.

CMC recommends that the Commission not pursue aggregation of positions based upon mere affiliation. Instead, the Commission should extend the much less burdensome independent account controller safe harbor to all separately organized companies, affiliated or not. Any aggregation rulemaking should be consistent with the CEA and historic Commission rules and require aggregation only in instances where there is direct ownership of a trading account or trading control. These criteria, in contrast to corporate ownership, have consistently proved effective in terms of detecting and preventing manipulative trading and excessive speculation.

7. Reporting Requirements

CMC appreciates the Commission's changes in the Proposed Rule from the vacated rule which do not require the daily reporting of cash positions – positions over which the CFTC lacks regulatory authority. However, the reporting required by the proposed rule remains onerous and burdensome for commercial end-users, especially the reporting required when end-users need to utilize bona fide hedging exemptions and must report certain positions on an aggregate basis which many include positions held in separate business units or global affiliates. CMC notes that this reporting by end-users is far and above anything required by speculators, and requests that the Commission allow for commercial reasonableness in the reporting standard for commercial end-users.

Additionally, CMC is concerned that the required reporting may impose significant liability for both an organization and its employees, as several of the requested forms require an individual employee of an organization to certify the data provided is true and correct, despite the inherent difficulty in making such a certification when data may be collected from legal entities or counterparties who are not accountable to that employee or even to the reporting organization. This is a particular concern for a global organization when a firm may have to report certain overseas positions or assets to meet CFTC reporting requirements. Section 6c(2) of the CEA[30] already prohibits the submission of false or misleading information; CMC is unaware of any problems relating to industry-submitted information relating to physical markets that would justify adding yet-another cause of action by requiring companies to certify reports. Absent some further explanation by the Commission of the inadequacy of Section 6c(2) of the CEA in sufficiently incentivizing accurate reporting, CMC does not believe the additional requirement of information being certified as "true and accurate" is either justified or appropriate.

8. Inadequacy of the Proposed Exemption for Pension Plans

The Proposed Rule seeks to address the concern that the positions of a retirement plan would need to be aggregated with the commodity interests of the plan sponsor. Under the Proposed Rule pension plans would be able to exclude the positions of the plan sponsor, and the plan sponsor would be able to exclude the positions of the plan, to the extent the retirement plan is able to avail itself of the independent account controller exemption. Unfortunately, this proposed approach is not an option for many retirement plans. For this reason the Commission should exclude retirement plans subject to the Employee Retirement Income Security Act ("ERISA") outright from the aggregation requirements.

[30] Section 6c(2) of the CEA states: "It shall be unlawful for any person to make any false or misleading statement of a material fact to the Commission, including in any registration application or any report filed with the Commission under this chapter, or any other information relating to a swap, or a contract of sale of a commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or to omit to state in any such statement any material fact that is necessary to make any statement of a material fact made not misleading in any material respect, if the person knew, or reasonably should have known, the statement to be false or misleading."

ERISA generally requires that retirement plan fiduciaries act solely in the interest of plan beneficiaries. Thus they are by law prevented from considering the positions of the plan sponsor when making commodity investments. To the extent the Commission views this existing legal requirement as insufficient the Commission could further condition relief on the requirement that plans and sponsors not make trading decisions in order to benefit from the trading decisions of the other. If the Commission fails to exempt ERISA plans and their sponsors from the requirement that their commodity positions be aggregated together it will be disruptive to these plans, their beneficiaries, and the markets generally.

9. Conclusion

CMC recognizes the effort and thought the Commission and its staff put into the drafting of the Proposed Rule. CMC also acknowledges the Commission's crucial oversight that fosters transparent, open, competitive and financially sound commodity markets. In adopting a final rule for federal position limits, CMC urges the Commission to be mindful of its role in protecting the longstanding and crucial ability of commercial end-users to utilize commodity derivatives markets to manage risk.

CMC appreciates the commission's consideration of this letter on this most important subject. Should you have questions regarding this topic or wish to discuss further, please contact me at Gregg.Doud@commoditymkts.org or by phone at (202) 842-0400 x 101.

Sincerely,

Gregg Doud
President, Commodity Markets Council

Cc: Hon. Mark P. Wetjen, Acting Chairman
Hon. Bart Chilton, Commissioner
Hon. Scott D. O'Malia, Commissioner

APPENDIX I: EXAMPLES OF BONA FIDE HEDGING TRANSACTIONS

The following examples represent a non-exclusive list of common hedging transactions entered into by commercial firms in agricultural and exempt commodity markets. The Commodity Markets Council ("CMC") respectfully requests the CFTC ensure the transaction types represented by these examples are included within the definition of bona fide hedging in the context of any federal position limits regime.

I. UNFIXED (FLOATING) PRICE COMMITMENTS.

A. IN THE SAME CALENDAR MONTH.

The following example demonstrates the potential need to hedge basis risk in the same delivery month, but at a different delivery location. If one used a cash-settled swap in one location and a physical delivery futures contract at the other, these positions would not offset, yet the clear intent of the transactions is to establish a bona fide hedge position.

Example: A natural gas ("NG") wholesaler buys gas at (Point 1) and sells it at another point on the same pipeline (Point 2) to a different counterparty. Both contracts are at an index price plus or minus a differential. In order to lock in the current spread relationship between the prices at the two delivery locations, NG wholesaler sells a NYMEX Henry Hub futures contract and enters into a "long" swap on the price at Point 2, hedging the risk that the price at Point 2 will decline relative to the price at Point 1. The purchase and sale will occur during the same delivery month.

B. IN A DIFFERENT COMMODITY.

The following examples demonstrate the potential need to hedge basis risk between two different commodities. Basis risk can be assumed for many reasons, including a commercial process utilizing one commodity to produce another or transportation of a commodity to a location which prices off of a different index or reference price. Basis risk occurs in the normal course of physical business, and mitigating this risk through the derivatives market represents a clear intent to establish a bona fide hedge position.

Example 1: Power plant operator X buys natural gas from which it generates and sells power. It buys gas from one party at Natural Gas Henry Hub futures price plus or minus a differential, and sells power to a different party at Power Index B plus or minus a differential. In order to lock in the basis between gas and power prices, Power plant operator X enters into a swap on the prices of Power Index B and Henry Hub futures contracts in natural gas, effectively hedging the risk that the price of power will decline relative to the price of gas. The two prices are referencing different commodities.

Example 2: Firm A enters into an agreement to purchase physical oil in the North Sea at an unfixed (floating) price, to be determined based upon the price of March ICE Brent crude oil futures on specified days plus or minus a fixed differential (i.e., 50 cents). Firm A sells that oil to a refinery in the U.S. Gulf Coast at an unfixed (floating) price to be determined based upon the price of April NYMEX WTI crude oil futures plus or minus a fixed differential. Firm A is exposed to the risk that between the dates of these transactions and their pricing, the price of Brent will rise relative to the price of WTI. Accordingly, Firm A places a hedge by purchasing ICE Brent crude oil futures and selling NYMEX WTI crude oil futures to lock in the differential.

II. "ANTICIPATED" TRANSACTIONS.

The following examples demonstrate the potential need to hedge risk based on anticipated commercial transactions. End-users and commercial participants in the energy and agricultural sectors utilize derivatives to hedge anticipated production, purchases, sales, and other transactions. As noted throughout this letter, hedges of "anticipated ownership" and "anticipated merchandising" transactions are bona fide hedges under the language in the Dodd-Frank Act. The clear intent of these anticipatory hedging transactions is to establish a bona fide hedging position to mitigate commercial risk.

Example 1: Commercial Entity X, a wholesale marketer of crude oil, has purchased a cargo of oil currently transiting the Atlantic from Europe to the US at the price of ICE Brent futures plus or minus a differential. It is negotiating to sell that cargo in the U.S. Gulf Coast at a price of NYMEX WTI plus or minus a differential. Although it has not concluded negotiations on the sale, it believes that it will do so in the next several days. In order to avoid the risk of adverse market moves affecting the value of the soon-to-be-consummated deal, Commercial Entity X places a hedge in NYMEX WTI futures.

Example 2: In the example above, the parties have concluded their negotiations and, as is standard in the industry, agreed to the transactions subject to credit terms and legal review of documentation. As such, there is a good faith expectation by Commercial Entity X that the transaction will be completed. Again, in order to avoid the risk of adverse market moves affecting the value of the soon-to-be-consummated deal, Commercial Entity X places a hedge in NYMEX WTI futures.

Example 3: In February of 2013, prior to spring wheat planting, Elevator X, which has storage capacity that is currently sitting completely empty, locks in a spread of $1.40 on a portion of its expected throughput for the crop year by buying July 2013 Wheat futures and selling July 2014 Wheat futures. Regardless of whether Elevator X actually buys wheat in 2013, this transaction represents a hedge by Elevator X of its capacity (i.e., the value of its grain storage assets). If there is a crop failure during the 2013 harvest resulting in little to no wheat deliveries at Elevator X, the spread position hedge will perform by providing Elevator X the economic value of the position hedging against such an event. Alternatively if Elevator X (as expected) buys wheat, it will hedge these specific price risks by taking appropriate futures positions and reducing the July/July Wheat spread.

Example 4: A gasoline blender uses various feedstocks (for example Alkylate, Reformate and Natural Gasoline) to produce reformulated gasoline. Feedstock prices are fixed when the feedstocks are purchased. The blender has contracts to supply reformulated gasoline to several regional "racks," and sales of the reformulated gasoline will be at prevailing market prices at the time of sale. The gasoline blender is at risk that the price of the feedstocks will rise before they are purchased. There are no futures or swaps contracts for the components. As a result, the gasoline blender buys NYMEX RBOB in the volume similar to its anticipated requirements of feedstocks to hedge the price risk on its unfilled anticipated requirements.

Example 5: Firm W is offered the opportunity to buy a cargo of crude oil, scheduled to load in West Africa at a price of ICE Brent plus or minus a differential. Firm W calculates all of its costs of the transaction and recognizes that as a result of supply and demand conditions in the U.S. Gulf Coast, it could make a profit if it bought the product, moved it to the U.S. Gulf Coast, and sold it at the current market price of the NYMEX WTI futures contract in the expected month of delivery. However, if Firm W simply purchased the cargo as offered, it would be exposed to the risk that

the price of ICE Brent would increase relative to the price of NYMEX WTI before it entered into an agreement to sell the cargo. Accordingly, Firm W buys the cargo, and enters into an anticipatory hedge in which it buys ICE Brent futures and sells NYMEX WTI futures. This derivatives transaction is inherently risk-reducing in nature and allows the movement of petroleum products from one market to another to address relative supply and demand fundamentals.

Example 6: Firm S, a global merchandizer, is involved in marketing Brazilian ethanol into the Far East. Firm S is being approached by a Brazilian producer to sell 50k cubic meters of ethanol for a 12 month forward shipment. However, the consumers in the Far East are not willing to adopt the deferred risks inherent in contracting for a 12 month term. The value of the ethanol long position Firm S holds in the form of the 12 month forward shipment can be materially drawn down in the event a decline in No. 11 ICE sugar futures, in which case the Brazilian cane industry is incentivized to divert the sucrose from sugar production into better-paying ethanol production and eventually creating an oversupply in the export ethanol market as well. Firm S therefore takes a short position in No. 11 ICE sugar futures to hedge the risks of its ethanol long position.

III. HEDGING OF SERVICES.

The following examples demonstrate the potential need to hedge risk based on the value of services, or anticipated services. Though commercial firms may not intend to ever take possession of or deliver a physical commodity, the services provided by the commercial participant are directly related to the price of the commodity, and commercial risk can be mitigated through the use of derivatives markets. As discussed in this letter, hedges on the value of "services that a person provides or purchases, or anticipates providing or purchasing" are bona fide hedges under the language in the Dodd-Frank Act. The clear intent of these derivatives transactions by service providers or consumers is to establish a bona fide hedging position.

Example 1: Commercial energy firm Z is a wholesale marketer of natural gas. It has an opportunity to acquire one year of firm transportation on Natural Gas Pipeline ("NGPL") from the Texok receipt point to the Henry Hub delivery point for an all-in cost of $.30/mmbtu. The "value" of that service at that time is $.33/mmbtu, measured as the difference between the price at which one can sell the natural gas at the delivery point minus the price at which one can purchase the gas at the receipt point. At that time, commercial energy firm Z can enter into a swap locking in the calendar 2012 strip at Texok at a price of $4.00/mmbtu and sell a calendar strip of NYMEX Henry Hub natural gas futures contracts locking in a sale price at a weighted average of $4.33/mmbtu. Entering into those two separate transactions without having actually purchased or sold natural gas to transport has allowed commercial energy firm Z to hedge the value of the firm transportation service that it holds or can acquire.[31]

Example 2: Producer X, a producer of natural gas, has new production coming on line over the next few years in the Gulf of Mexico. The production is located near Point A on Pipeline Y's interstate natural gas pipeline system. Producer X has the desire to sell gas to customers in Region B as the price for natural gas in Region B is significantly higher than at Point A, where natural gas would currently be delivered into Pipeline Y's system. Producer X contacts Pipeline Y and negotiates a Precedent

[31] Note that this "value" exists whether Commercial energy firm Z ever owns or intends to own the physical commodity. In some circumstances, the firm might choose to release the capacity to a third-party and realize the value of the transportation service from the capacity release transaction.

Agreement with the pipeline under which Pipeline Y will build new transportation capacity from Point A to Region B. Under the Precedent Agreement, Producer A is obligated to pay demand charges to the pipeline for a term of 5 years from the date the pipeline goes into commercial operation, if Pipeline Y is able to complete a successful open season and obtains the necessary permits to construct and operate the new section or expansion of its pipeline system from Point A to Region B. The open season is designed to attract commitments from other potential shippers to help support the cost of building and operating the pipeline expansion. The schedule calls for a completion of construction and commercial operation of the pipeline expansion on March 31, 2014.

Producer X is concerned that the natural gas price differential between Point A and Region B could collapse and is fairly confident the expansion project will be completed. In order to manage the risk associated with the 5-year financial commitment to Pipeline Y, i.e., pipeline demand charges, Producer X enters into swaps at Point B for a term of April 1, 2014 to March 31, 2019, to lock-in the price spread between Point A and Region B. In this case, the expansion of the pipeline system that would afford customers in Region B more access to lower priced gas might not occur without the ability to count the swaps associated with this transaction as a bona fide hedge.

Example 3: Commercial energy firm A is an electric utility that owns coal-fired generation facilities. Firm A enters into contracts with major railroads to transport coal from producing regions to its various generating facilities. One or more of these contracts are subject to a fuel surcharge, whereby rates paid by firm A to transport coal are indexed to the price of diesel fuel. As prices for the diesel fuel rise, the rate paid by Firm A to transport coal also rises. To mitigate this risk, Firm A enters into a long position in futures contracts or swaps for the diesel fuel, whereby gains realized on these instruments should prices rise will off-set any increase in the rate paid by Firm A to transport coal.

IV. HEDGES OF "SPREAD" OR "ARBITRAGE" POSITIONS.

The following examples demonstrate the potential need to hedge risk based on spread or arbitrage positions. End-users and commercial participants frequently utilize spread or arbitrage trading as a part of their business strategy, and utilize hedging to protect against downside risks of normal business strategy. Hedges on the value of spread or arbitrage positions would be bona fide hedges under the language in the Dodd-Frank Act. The clear intent of these derivatives transactions by end-users or commercial participants is to establish a bona fide hedging position for spread or arbitrage positions entered into in the normal course of business.

Example 1: The business model of Company X is to import crude oil from Europe to the United States. On an average year it imports 48 million barrels of crude oil. Its purchases in Europe are generally priced against Brent crude oil and its sales in the United States are priced against WTI crude oil. Those prices are readily available across the price curve, more than a year in advance. There are times when Company X believes the differential for a particular month is favorable and it seeks to lock in that differential by buying Brent swaps and selling NYMEX WTI futures, knowing that it will ultimately buy the oil priced in Brent and sell the oil priced in WTI. This transaction allows Company X to hedge the risk of its business strategy and expected transactions.

Example 2: Grain Merchandiser X is in the business of buying wheat in, among other places, North Dakota, using a Minneapolis Grain Exchange (MGEX) reference price. Grain Merchandiser X is also in the business of selling wheat to Italian flour

mills, using a Euronext France (MATIF) price. These prices are readily available across the price curve, more than a year in advance. As such, there are times when Grain Merchandiser X believes the differential for a particular month is favorable and it seeks to lock in the differential by selling MATIF futures (or swaps) and buying MGEX futures, even though it will ultimately buy North Dakota wheat priced in MGEX futures. This transaction allows Grain Merchandiser X to hedge the risk of the expected transactions in its business strategy.

Example 3: Merchant Firm C analyzes the current physical coffee market in terms of supply and demand and sees potential demand above delivery values for the existing certified coffee inventory. Moreover Firm C can demonstrate that the total cost of carrying the current existing certified coffee inventory from the first delivery day of March 2014 until the first delivery day of May 2014 is 3.00 c/lb. The spread is trading at -3.20 c/lb.

The merchant approaches the DCM for an exemption to hold spot month futures longs in excess of the spot position limit provided that the spread between the first and the second futures contract at which the position is entered exceeds a discount of 3 c/lb. The merchant demonstrates to the exchange that the total costs of carrying existing certified coffee inventories (including rent, finance, insurance, and the penalties prescribed in the futures contract) are no larger than the income generated by buying the nearby spread at the level stated. The DCM, at its complete discretion, grants an exemption to the spot month position limit subject to the following conditions: 1) the overall spot month position the merchant may hold is limited in view of the economics presented and the certified inventory already controlled by the merchant; 2) the spread level at which this spot month position may be entered into has to exceed a certain discount (namely the total costs of carry, e.g. -3.10); and 3) the long nearby spread position in question has to be liquidated during the notice period (ensuring the market does not enter backwardation).

Once delivery starts there are two possibilities: a) the holder of certified stocks chooses to deliver, and the longs held on the back of the straddle/arbitrage exemption are liquidated as a result; or b) the holder of certified stocks chooses not to deliver In which case the holder of the straddle/arbitrage exemption is free to liquidate his long spread position at any value, subject to the conditions under point 3 above.

V. HEDGING IN THE LAST FIVE DAYS OF TRADING AN EXPIRING CONTRACT.

The following examples demonstrate the potential need for commercial participants to hedge risk in the last five days of trading in a specific derivatives contract. The uneconomic consequences of prohibiting a bona fide hedge positions from being held in the last five days of trading are also demonstrated. The clear intent of holding these derivatives in the last five days of trading by commercial participants is to maintain a bona fide hedging position.

A. ACTUAL CONTRACTED REQUIREMENTS.

Example: Commercial entity C operates a corn processing plant. Commercial entity C has sales obligations of corn products to customers larger than its ownership of corn to satisfy those obligations. It has purchased futures contracts in the exchange traded market to offset the price risk of the sales obligations beyond its ownership of physical corn. Assume the sales of entity C represent 4 weeks of production, and current ownership represents 2 weeks of production. Commercial entity C has purchased futures representing the other 2 weeks of production, protecting its price risk on that amount. It is economically correct for the entity to purchase corn at the

lowest cost available. A restriction on bona fide hedge positions in the last five days of the contract period would prevent the market from behaving economically and converging to where the costs are equivalent. If holding positions in the last five days of trading were prohibited, the cost to the enterprise of taking delivery of physical corn through the exchange regulated process may be more (or less) cost effective than corn that is offered for sale in the cash market. The cost to entity C should be the same, whether taking corn through the exchange delivery process or purchasing the offers in the cash marketing channels, given the same quality and logistical parameters.

B. UNSOLD ANTICIPATED PRODUCTION.

Example: Company A anticipates producing 2000 barrels of crude oil in July based on prior months actual production. The July production is currently unsold. To hedge its risk that the value of those barrels may decline prior to their sale, Company A will sell 2 July NYMEX WTI crude oil futures contracts, which represent delivery ratably during the month of July. The last trading day of the July futures contract is June 21st. If Company A were prohibited from holding the hedging position in the last five days of trading, the last day that Company A could hold the position is June 14th. This means that if Company A holds the contract from June 15th through June 21st and delivers its oil under the July futures contract, it could not treat those positions as a bona fide hedge during that period. Alternatively, in order to maintain bona fide hedge status, it would be required to roll its hedge into the August contract on June 14th, taking basis risk on the July/August spread for the additional 5 days.

C. UNFIXED PRICE CONTRACTS.

Example: Company B has a contract to buy natural gas at the Henry Hub in July at NYMEX + $.10 and a contract to resell it at the Henry Hub in August at NYMEX + $.15. To hedge the basis risk, it sells NYMEX July futures and buys NYMEX August futures. If Company B could not hold the hedging transaction in the last five days of trading, it would be forced to roll its position to a less efficient hedge.

D. CROSS-COMMODITY HEDGES.

Example 1: Commercial energy firm J supplies jet fuel to airlines at a variety of airports in the United States, including Houston Intercontinental Airport. It has a fixed-price contract to purchase jet fuel from a refinery on the U.S. Gulf Coast during early June. Because there is no liquid jet fuel futures contract, commercial energy firm J uses the June NYMEX physically-delivered WTI crude oil futures contract to hedge its price risk. If commercial energy firm J were prohibited from holding its hedging position in the last five days of trading, commercial energy firm J would be required to liquidate its hedge before the last five trading days of the June contract and either remain unhedged or replace its June hedge with a contract that represents a different delivery period and, therefore, a different supply/demand and pricing profile.

Example 2: AgriCorp, a grain warehouse, grain merchandiser and feed ingredient wholesaler, buys wheat from farmers. At the same time, Agricorp enters into a fixed price agreement with a feedyard to supply feed (the exact components of which could be satisfied using wheat, corn, DDGs, or other ingredients). In order to hedge its risk, AgriCorp enters into a swap, hedging the risk that the price of wheat will decline relative to the price of corn (the corn futures price better correlates to feed prices, thereby providing a more effective hedge). Since the two prices are

referencing different commodities, this hedge would not constitute a bona fide hedge if held in the last five days of trading.

VI. HEDGES ON ASSETS.

The following example demonstrates the potential need for commercial participants to hedge risk based on assets owned or potentially-owned which are significantly related to the derivatives contract. Though commercial firms may not intend to ever take possession of or deliver a physical commodity, the assets owned by the commercial participant are directly related to the price of the commodity, and commercial risk of owning the asset can be mitigated through the use of derivatives markets. The clear intent of establishing this derivatives position is to maintain a bona fide hedging position and reduce risk.

Example: XYZ Corp. is planning on buying a liquefied natural gas ("LNG") vessel. The value of that asset is based upon the spread between natural gas prices between and among various continents. XYZ will need financing in order to make the purchase. The lenders will only make a loan if XYZ can demonstrate a level of certainty as to its future revenue stream. As it negotiates with the shipbuilder and as it negotiates with lenders, the current differentials are favorable for robust demand for LNG. XYZ wants to enter into separate swaps and/or futures positions in the US, Europe and Asia to lock in the potential purchase prices in producing regions and the potential sales prices in consuming regions at current differentials. This will allow it to lock in the value of LNG transportation and satisfy lenders that this is a good credit risk for them to take on. Though XYZ, as the ship-owner, does not own or anticipate owning the underlying commodities, XYZ has entered into the swaps and futures contracts for the purpose of hedging.

VII. PRE-HEDGING.

The following example demonstrates the potential need to "pre-hedge" anticipated risk based past experience of physical transactions which may be conducted outside the hours in which the derivatives exchange is open. The clear intent of establishing this derivatives position is to mitigate risk which can reasonably be anticipated to occur and thus establish a bona fide hedging position.

Example: In the normal course of business it is common for Commercial grain company X to buy/sell flat price commodities outside the hours of operation for a particular futures exchange. It is not prudent to limit business activity to only those hours that the exchanges are open. This business activity creates a need for Commercial grain company X to establish a futures position in anticipation of buy/sell activity that cannot be hedged until a particular exchange opens. This futures position is established in advance of the cash transaction and is referred to as a "Pre-Hedge." The "Pre-Hedge" volume is based on the actual experience of Commercial grain company X in a particular market and is well established over time. As one might imagine, the "Pre-Hedge" for Commercial grain company X over any given weekend during peak harvest season could be quite large. The inability to "Pre-Hedge" these anticipated cash transactions would put Commercial grain company X at significant risk of price fluctuation that can take place outside the hours of operation of the futures exchange, especially during a weekend.

VIII. CROSS-HEDGING.

The following example demonstrates the potential need to enter into a cross-hedge due to manage risk in an export-oriented business. The clear intent of establishing this derivatives position is to mitigate risk through the establishment of a bona fide hedging position.

Example: Firm X owns a sugar refinery in Asia. The refinery is fully export-oriented and its revenue stream is driven by the differential between raw sugar procurement costs and white sugar export prices. The procurement price of raw sugar is correlated to the No. 11 ICE raw sugar contract while the residual variation is driven by freight and other costs. The structure of the regional white sugar market is such that though the sales prices are correlated to the LIFFE No. 5 white sugar futures contract, the majority of the export transactions are sold in small installations for immediate pickup and no forward price cover is available. Therefore, for protection of its refining margin, Firm X has no plausible risk management tool other than taking a short position in the LIFFE No. 5 white sugar contract and a long position in the No. 11 ICE raw sugar contract to lock in its raw sugar crush margin.