American Sugar Refining, Inc.
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February 10, 2014

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

**_VIA ELECTRONIC MAIL_**

*Re: Position Limits for Derivatives, RIN No. 3038-AD99*

Dear Secretary Jurgens:

By a Notice of Proposed Rulemaking published in the Federal Register on December 12, 2013,[1] the Commodity Futures Trading Commission ("CFTC" or the "Commission") has proposed to institute a speculative position limits rule for certain "core referenced futures contracts" and futures, options, and swaps deemed to be economically equivalent to such contracts ("NOPR").[2] Among the core referenced futures contracts are two sugar contracts, ICE Sugar No. 11 and ICE Sugar No. 16, which are commonly used for hedging by commercial participants in sugar markets.[3]

Given the potential impact that the NOPR will have on the overall sugar market, American Sugar Refining, Inc. and its affiliates ("ASR") respectfully request the Commission to take into consideration the significant adverse impact that certain aspects of the position limits rules will have on commercial sugar producers as set forth herein and to align the requirements of the proposed limits with the agricultural direction specific to business needs of agriculture, including specifically the sugar industry.

**<u>Overview</u>**

ASR is a global cane sugar refiner with more than 100 years of experience in all aspects of the manufacturing and selling of sugarcane products. ASR's operations include the farming, milling, refining, and merchandising of sugarcane products. ASR operates sugar refineries in five countries and owns and operates sugar mills in Mexico and Belize. ASR is primarily a sugar

[1] *Position Limits for Derivatives*, 78 Fed. Reg. 75680 (Dec. 12, 2013) ("NOPR").

[2] The NOPR proposes regulations to impose position limits on core referenced futures contracts and economically equivalent contracts pursuant to the Commodity Exchange Act ("CEA") (*See* 7 U.S.C. § 6a(a)(2), (5) (2013)), as the same was amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") (Public Law No. 111-203, 124 Stat. 1376 (2010)).

[3] NOPR at 75826, proposed § 150.2(d).

refiner, meaning that it purchases raw sugar from multiple origins, processes the raw sugar into a variety of cane sugar products, including refined sugar, and then markets and sells such products in a variety of markets. The ability to source raw sugar for its operations, and to hedge its raw sugar needs, is critical to the continuation of the business because of the small margins associated with the refining business. ASR's shareholders produce raw and refined sugar within and outside the United States. Including its shareholders, ASR has the collective capacity to manufacture approximately six million tons of refined sugar.

As is common in the sugar industry, ASR traditionally hedges its sugar price risk using futures contracts. To a much more limited degree, ASR engages in over the counter ("OTC") swaps for hedging, and physical trade options for addressing variable quantity sales and supply requirements. ASR has historically obtained hedge exemptions from exchanges to the extent required for its business based on the clear hedging needs of its physical sugar business. The current futures products in the sugar industry have historically worked well as hedging and price discovery tools for the sugar industry, which is a specialized agricultural industry that requires significant capital investment and long-term commitment to a specific agricultural commodity. ASR and similarly situated sugarcane producers have seen little need to use other tools, such as OTC swaps, because the current sugar futures market is suitable to the unique attributes of the sugar industry as further detailed below.

While ASR is not aware of the need to combat excessive speculation in the current sugar market through imposition of new position limits, ASR does not object to the Commission improving the market as a whole. However, ASR respectfully requests the Commission to consider the overall impact of implementing a rule that would adversely affect the entire supply chain of the sugar industry and particularly the ability to undertake effective and economic hedging or impose significant burdens not present today.

As ASR understands the NOPR, the Commission intends to create an overlay beyond today's exchange-based position limits in which: (1) entities will be required to aggregate and track their positions in affected futures, options, swaps, and physical contracts in real time on a futures equivalent basis; (2) limits must be monitored and complied with in real time with both spot and all month position limits; (3) limits can be exceeded only if the contracts held in excess of the limits are enumerated bona fide hedges; and (4) if the limits are exceeded, various forms that reflect cash and hedge positions across the aggregated entity group must be filed with the Commission. The current exchange position limits would also stay in effect but will need to reflect the enumerated bona fide hedges of the NOPR.

If the Commission enacts a final rule for commercial agricultural and manufacturing participants, ASR requests that the Commission:



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- If it chooses to adopt its enumerated *bona fide* hedge rules, assure that the hedges permitted thereunder are not inadvertently limited to prevent their legitimate use by affected hedgers - *in particular, bona fide hedges for sugar should not be subject to a 12 month limitation*; and
- Abandon its enumerated *bona fide* hedging proposal in favor of using the definition of "hedging or mitigating commercial risk" it has developed for use in the end-user exemption to mandatory clearing; and
- Reduce the complexity and compliance burden of its proposal on hedgers by using a model more similar to today's exchange-based hedge exemption process.

## ***Bona Fide*** **Hedges for Sugar Should Not be Subjected to a Twelve Month Limitation**

As proposed by the Commission, bona fide hedges for agricultural commodities are subject to a twelve month limitation if they are for hedges of unfilled anticipated requirements,[4] hedges of unsold anticipated production,[5] or hedges of services.[6] Non-agricultural commodities are not subject to such a limitation. ASR understands that the reason agricultural commodities are subjected to a twelve month time horizon is that, generally, crops are typically grown and hedged on an annual cycle. As a general matter, a twelve month limitation for an annual cycle crop appears reasonable as positions beyond the harvest cycle could be speculative rather than hedging.

Sugar, however, is different. Sugarcane is not a product that is harvested and replanted on an annual cycle such as certain other agricultural crops. Rather, sugarcane is unique in that it is subject to multiple harvests. Sugarcane is more akin to a natural resource with a production life than it is to an annual agricultural crop.

The economics of an annual cyclical agricultural product generally revolve around a one year period of planting, fertilizing, and harvesting which is repeated each year. There are discrete annual expense and revenue events that can be hedged in a twelve month cycle.

Sugarcane, on the other hand, has a longer lifecycle. After initial planting, sugarcane matures in an approximately twelve to fifteen month period. It is then harvested, followed by additional maturation of the same plants and further harvested over a conservative, 3-5 year period. In fact, in certain climates and locales around the world, the lifecycle of a single sugarcane plant subject to multiple harvests is upwards of 10-15 years. Thus, the economic cycle of sugarcane differs from, and is significantly longer than, that of annual crops. The economics of expenses and revenues of the sugarcane cycle are such that a legitimate hedge of, for example, unsold

[4] *Id.* at 75824 (proposed § 150.1, proposed definition of "bona fide hedging position" at (3)(iii)).
[5] *Id.* (proposed § 150.1, proposed definition of "bona fide hedging position" at (4)(i)).
[6] *Id.* (proposed § 150.1, proposed definition of "bona fide hedging position" at (4)(iv)).


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anticipated production, will reasonably extend beyond twelve months. The same is true for services associated with production and unfilled anticipated requirements of those purchasing the production.

Further, once harvested, the cane must be immediately milled to produce commercially economic quantities of raw sugar. Thus, investments in milling facilities located in close proximity to sugarcane fields must be made. Such facilities cost between $100 and $500 million dollars. The ability to hedge cash flows in a manner that is congruent with production cycles is needed to support this capital investment. Once capital expenditures of these levels are made, the sugarcane farmer will be planting and producing sugarcane on their land for the long term. A quick survey of the leading sugarcane producers in Florida, Louisiana and Hawaii will demonstrate that these farmers have been raising sugarcane on the same land for over 50 years. This demonstrates, not just a theoretical risk horizon, but a proven track record of exposure to price risks in the sugar markets over an extended time horizon.

As previously indicated, ASR is also a processor and refiner of raw sugar. A typical refinery will cost between $100 million and $500 million depending upon the capacity, the location and the number and type of products produced. A sugarcane refinery can only be used for processing raw sugar. It cannot be converted to process any other agricultural products. A refiner must anticipate market requirements and look for opportunities to purchase raw sugar at the lowest possible price. ASR, like other refiners, actively utilizes the futures market to manage this exposure. Like the other elements of the sugar chain of production, this exposure is not limited to a twelve month cycle and legitimate hedging should not be so limited.

ASR's customers are food processors that also manage their refined sugar purchase costs with contracts greater than 12 months. They often use futures contracts for this purpose rather than direct priced purchase contracts with refiners such as ASR. These risks are not tied to an agricultural cycle. These legitimate and bona fide hedging requirements of ASR's customers should also be considered when evaluating the impact of these rules.

Further, one of ASR's refineries on Lake Ontario is subject to the closure of the St. Lawrence Seaway for about 5 months each year due to freeze conditions. As a result, ASR must buy raw sugar stocks in advance and utilize futures contracts to manage spread risks. These are real operational and physical risks that must be managed. These risks are not tied to a twelve month agricultural growing cycle.

Finally, ASR actively purchases raw sugar from producers around the world. ASR is actively involved in Fair Trade and other programs. These 3rd party sugarcane farmers face the same extended period price risks faced by ASR. As a refiner dependent upon these 3rd party farmers



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for supply, it is important to the sugar industry that such 3rd party farmers also have the ability to manage their price risks associated with forecasted production beyond a twelve month time horizon. Given the long term capital risks, another concern of ASR's is that a limitation on hedging such risks may increase the cost of capital or deter capital investment.

For the foregoing reasons, and specifically due to its unique lifecycle, ASR requests that sugar not be subjected to a blanket twelve month limitation placed on agricultural commodities. Instead, the Commission should recognize the particular facts and hedging needs of physical sugar producers, such as ASR, using sugar futures as legitimate hedges.[7] It would be arbitrary to exclude legitimate hedging of sugar contracts from *bona fide hedge* status without fully considering the relevant facts and circumstances that are specific to the sugar market and overall impact on the sugarcane supply chain.

**The Five Day Rule Should Not Apply to Sugar Contracts**

As described by the Commission,[8]

> [t]he ''five-day rule'' is a provision in many of the enumerated hedging positions that prohibits a trader from maintaining the positions in any physical-delivery commodity derivative contract during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract.

The contract used most broadly by commercial sugar companies to hedge their risk is the ICE Sugar No. 11 Futures which has settlement by physical delivery, FOB receiver's vessel.[9] As proposed in the NOPR, the five-day rule would apply to: hedges of unfilled anticipated requirements,[10] hedges of unsold production,[11] hedges of offsetting unfixed-price cash commodity sales and purchases,[12] hedges of anticipated royalties,[13] hedges of services,[14] and cross–commodity hedges.[15]

If the five-day rule is applied in a blanket fashion, then those using futures contracts as a hedge will be exposed to price volatility risk during the period it cannot be used as *a bona fide* hedge. Hedgers will be forced to alter their hedging techniques by abandoning the most liquid contract

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[7] ASR currently holds a hedge exemption on the ICE exchange recognizing the legitimacy of its hedging to offset the commercial risk of its sugar business.

[8] NOPR at 75762-63 (internal footnote omitted).

[9] ICE Sugar No. 11 Futures Contract.

[10] NOPR at 75824 (proposed § 150.1, proposed definition of "bona fide hedging position" at (3)(iii)).

[11] *Id.* (proposed § 150.1, proposed definition of "bona fide hedging position" at (4)(i)).

[12] *Id.* (proposed § 150.1, proposed definition of "bona fide hedging position" at (4)(ii)).

[13] *Id.* (proposed § 150.1, proposed definition of "bona fide hedging position" at (4)(iii)).

[14] *Id.* (proposed § 150.1, proposed definition of "bona fide hedging position" at (4)(iv)).

[15] *Id.* (proposed § 150.1, proposed definition of "bona fide hedging position" at (5)).

traded on the exchange in favor of financially settling alternatives. As today's hedge exemptions permit the use of the ICE Sugar Nos. 11 and 16 Futures contracts for legitimate hedging, the position limits in the NOPR should do the same. There is no underlying concern to disrupt the effective and well understood use of this contract to hedge commercial sugar risk.

**The Commission Should Define the Scope of Permissible Hedging More Broadly**

As a global sugar producer and processor, ASR has two roles in the industry - it sells raw sugar to third parties from its production and also purchases raw sugar from third parties for its processing operations. In operating its business, ASR must prudently utilize hedging to manage price risk. Thus, ASR views its hedging of the commercial risk of its businesses as being in alignment with the definition of hedging developed by the Commission in its regulations implementing the Dodd-Frank end-user exemption to mandatory clearing.[16] That is, in general, a transaction is a hedge if it appropriately mitigates a commercial risk arising from the variability of the costs of product, services, and interest rates/currencies.[17] If such a commercial risk can be effectively and economically ameliorated with, for example, a futures contract, then that futures position is a legitimate hedge. Such a hedge is no less *bona fide* than the enumerated hedges proposed by the Commission.

Further, as the enumerated hedge rules appear to require a matching of a particular hedging transaction to a particular *bona fide* hedge, it does not appear to permit an organization, such as ASR, to hedge its risk on a portfolio basis. ASR experiences risks from its sugar business across all contracts it enters in to – not from each contract separately or alone. It needs that ability to effectively manage commercial risk on both a case-specific and portfolio basis. The matching component embedded in the enumerated hedge approach appears to limit an organization's ability to address its risks on a portfolio basis and have those transactions recognized as *bona fide* hedges.

Accordingly, ASR respectfully requests that the Commission eliminate the complex and non-comprehensive definitions of the enumerated *bona fide* hedges altogether and replace them with the test for "hedging or mitigating commercial risk" used in the end-user exception regulations. If the Commission is concerned that such a test would be too broad if applied to speculators, it could limit its use to those who would also qualify for the end-user exception for the same transactions. To that end, hedgers would be permitted to hedge their commercial risks as they confront them. Financial entities and others that do not experience such risks could be

[16] *See* 17 C.F.R § 50.50(c).

[17] *Id*.



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constrained to the more limited definition if the Commission believes it necessary (since financial entities, swap dealers and others are not eligible for the end-user exception).[18]

**The Proposed Position Limits Rules are too Complex and Burdensome for Hedgers**

ASR believes that compliance with the proposed regulations will be overly burdensome and expensive with no corresponding regulatory benefit when applied to hedgers. The requirement to keep track of ASR's entire suite of affected contracts (including physical contracts) across all of its global operations (as well as those with which ASR is to be aggregated) on a real-time basis in futures equivalents will not only be complex, but will impose a significant compliance burden. As a hedger, ASR is undertaking a commercial business that requires futures contracts to prudently manage its business. It is not a speculator that is in the business of futures contracts.

The NOPR appears to require that hedgers, not speculators, bear the brunt of the proposal by imposing a need to implement a real-time global, multi-company aggregated tracking system of: (1) aligning all hedging transactions with enumerated hedges; (2) tracking positions in all affected contracts; (3) tracking cash market positions in accordance with the manner in which the forms required by the Commission can be populated; and (4) filing each required form timely and correctly. The foregoing requirements are not needed for commercial purposes. Unlike ASR or other commercial parties within the sugar industry, true speculators in futures contracts (i.e., those without any physical product) have a relatively minor burden to comply with the NOPR as opposed to the burden that would be imposed on legitimate hedgers, such as ASR. They will solely be for compliance with a final rule. ASR requests that the Commission take into consideration a less burdensome, yet suitable, system to meet the goals of the NOPR without disrupting the current sugar market. As shown above, the NOPR will harm sugar producers and processers by removing legitimate sugar hedging from *bona fide* hedge status.

**Enumerated *Bona Fide* Hedges Should be Established in Recognition of Cash Market Characteristics and Current Hedging Practices**

Assuming the Commission determines to move forward with its proposed use of enumerated *bona fide* hedges, ASR respectfully requests that it revise certain aspects of the NOPR to properly address the unique attributes of the sugar industry, and take into consideration such attributes through modifying the final rules.

ASR understands that, at the NOPR stage, it may be reasonable to propose a standard program that does not take into account the specifics of each affected market. However, before enacting any final rule, ASR requests that the Commission take into account any commodity-specific

[18] *Id.* at § 50.50(a).



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information provided by commenters and appropriately tailor the final rule to the identified facts and assure no unintended harm to legitimate hedging or to a specific agricultural commodity. Simply stated, the final rule for core referenced futures contracts should be based on the underlying facts of the commodity upon which it is directed, and designed such that it addresses the potential harm of excessive speculation without negatively impacting a specific commodity or legitimate hedging of that commodity. As further detailed above, (1) sugar-related *bona fide* hedges should not be subjected to a twelve month limitation, and (2) the so-called five-day rule should not apply to sugar contracts.

**Conclusion**

The foregoing will significantly impact the sugar market as it will potentially lose *bona fide* hedge status for certain of its hedges on exchanges and will certainly incur material compliance costs as well as compliance risk in attempting to timely satisfy the complex rules proposed in the NOPR. Given that ASR believes that its hedging program is working effectively and it is not at risk of harms from excessive speculation, ASR requests, if the Commission enacts a final rule based on the NOPR, that it not materially disrupt today's hedging market or impose costly and complex rules on hedgers unless they are manifestly necessary to prevent a meaningful threat to market integrity.

In accordance with the foregoing, if the Commission issues a final position limits rule, it should take steps to reduce the complexity and burden of commercial companies using futures markets to hedge commercial risk. Further, any position limits rule enacted by the Commission should not disrupt legitimate hedging activities conducted today. Finally and importantly, bona fide hedges for sugar should not be subject to a twelve month limitation under any position limits rules.

Respectfully Submitted,

David Johnson
*Vice President & Chief Risk Officer*
*American Sugar Refining, Inc.*

cc: Acting Chairman Mark P. Wetjen
Commissioner Bart Chilton
Commissioner Scott O'Malia



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