



August 4, 2014

By Commission Website

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

Re: RIN number 3038–AD99: 17 CFR Parts 1, 15, 17, et al., Position Limits for Derivatives; Proposed Rule, Federal Register/ Vol. 79, No. 128 / July 3, 2014

Dear Ms. Jurgens:

This letter is in response to the Federal Register notice of July 3, 2014 regarding the Proposed Rule for Position Limits for Derivatives and is made on behalf of Rice Dairy LLC. These comments are consistent with our comments filed on February 7, 2014, but further clarify our recommendation for position limits for dairy commodity derivatives, specifically class III milk.

The dairy industry is supportive of CFTC efforts to provide oversight of agricultural markets and impose constraints where there is credible evidence that price volatility does not originate from fundamental shocks, or where market conditions reasonably warrant ‘prophylactic’ regulation of speculative position limits. Given the facts regarding the dairy markets, it is our opinion that the challenge before the CFTC is to implement rules that stimulate, rather than needlessly arrest further growth of the dairy derivative markets. We hope you will find our comments helpful as you decide which rules to impose on fragile Class III milk derivative markets.

Following the public roundtable on June 19, 2014, the Commission requested comments to further consider certain issues regarding position limits for physical commodity derivatives. A unique feature of milk futures and options contracts is the high number of contracts held to expiration. Since the contracts are cash-settled to the monthly milk price announced by the USDA, and the contracts are used primarily for hedging purposes by dairy farmers and end-users, there is a “buy and hold” aspect to the market that does not occur in other commodity markets, especially those with physical settlement. As a result of this phenomenon, trading volume and market liquidity is often modest. Non-commercial trading activity is needed to improve both volume and liquidity in the dairy markets. Therefore, we are concerned about proposed rules that could make the dairy markets less attractive for liquidity providers.

Cash settled futures contracts, and dairy specifically, are different than physically settled contracts. First, the concerns about “cornering” a market in a physical commodity are less relevant when the contract is settled to a cash index. For dairy, the USDA calculates average monthly prices for milk and dairy products. These government-regulated prices are used to cash settle the CME dairy futures contracts. Therefore, we question whether position limits for cash settled contracts should be thought of in the same manner as physically deliverable contracts. Additionally, unlike corn or other commodities, spot month futures are not the primary determinant of day-to-day cash market pricing for dairy commodities. Finally, milk is highly perishable and cannot be stored for more than 72 hours. Thus, it is not possible to

accumulate class III milk in an attempt to “corner” the market. These important differences illustrate why the CME dairy contracts need to be viewed differently than other agricultural and non-agricultural markets.

We respectfully request the Commodity Futures Trading Commission (CFTC) set the front month’s Class III milk position limit at 25 percent of deliverable supply, but not less than 3,000 contracts and the all months limit at four times the front month limit, but not less than 12,000 contracts. In the original Federal Register notice, on Table 9 (page 75727), it noted the current spot month position limit for class III milk of 1500 contracts. This limit, and the all-months combined limit of 3400, is too restrictive. Since swaps are not accounted for currently, we believe the spot month limit should be at least double the current limit of 1500. Guidance from the CME Group using the alternative approach of establishing spot month limits at 25% of deliverable supply would increase this limit to 5300 contracts. We support the methodology the CME used to calculate the new proposed limit. We also support using the net position and not the gross position in order to account for offsetting long and short positions.

Using the 10/2.5 formula, the current non-spot month and all months combined limit for CME class III milk futures contracts of 3400 is too restrictive. However, we point out an inconsistency with this approach when compared to the spot month limit. If the spot month limit is established using 25% of deliverable supply, the limit is set at 5300 contracts. But, the non-spot month limit is 3400, 1900 contracts less. In practice, it does not make sense to establish a non-spot month limit that is less than the spot month limit. To resolve this inconsistency, we propose using the spot month limit of not less than 3000 contracts multiplied times 4 to establish the all-months combined limit of at least 12,000 contracts. Using 5300 contracts derived from the 25% of deliverable supply number, the all-months combined limit would equal 21,200. As of July 31, 2014, all-months combined limits of 12,000 and 21,200 contracts would represent 12.7% and 22.5% of total class III milk futures and options open interest, respectively. We believe those limits are appropriate given the potential growth of the dairy markets and need for limits that do not constrain or inhibit market participation.

The term “estimated deliverable supply” means the amount of a commodity that can reasonably be expected to be readily available to short traders to make delivery at the expiration of a futures contract. Class III milk contracts are settled using a monthly average milk price announced by the USDA’s Agricultural Marketing Service (AMS). Additionally, the Federal Milk Marketing Orders, administered by USDA AMS, collects and reports milk marketings and utilization on a monthly basis. As a result, the “estimated deliverable supply” and position limits for class III milk can be accurately defined using this government data. And since milk is highly perishable and not storable, there is no concern about potential manipulation of spot month deliverable supplies.

Dairy farmers market milk each month and routinely sell “packs” of multiple months of futures contracts. Given the continuous production aspect of milk, and the need to hedge milk sales a year or more in the future, it is imperative the futures market has enough liquidity to provide for this need. Therefore, we urge the Commission to work with DCM’s (e.g. CME Group) to establish appropriate position limits that allow broad participation from all market segments.

Summary of Comments

We thank the Commission for the opportunity to provide comments on the proposed rule for position limits. Our comments and recommendations are summarized as follows:

- We support establishing the spot month limit for class III milk at 25% of deliverable supply, but not less than 3000 contracts (net position and not gross position).
- Do not apply the 10/2.5 formula for establishing non-spot month limits.
- Instead, the all-months combined limit should be defined as the spot month limit multiplied by 4, but not less than 12,000 contracts.

The dairy industry has put significant effort behind developing risk management tools such as futures and options contracts at the CME Group. We are concerned about the potential to limit the activity of liquidity providers in dairy markets when efforts are being made to increase it. Impeding growth in those markets will result in the continued inability for our industry to use those tools. Our interest is in developing robust risk management tools for the dairy industry to manage the price volatility from an increasingly global dairy market.

We thank you for considering our comments and recommendations.

Sincerely,



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