

Will the CFTC Defy Congress's Mandate to Stop Excessive Speculation in Commodity Markets
and Aid and Abet Hyperinflation in World Food and Energy Prices?
- *Analysis of the CFTC's Proposed Rules on Speculative Position Limits* -

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On January 26, 2011, the Commodity Futures Trading Commission (“CFTC” or “Commission”) issued the Notice of Proposed Rulemaking on Position Limits for Derivatives¹ pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act² (the “Dodd-Frank Act”). The proposed rules are designed to implement the historic Congressional mandate of the Commodity Exchange Act, as amended by Section 737 of Dodd-Frank, to ban excessive speculation from the derivatives market, *i.e.*, the speculation which exceeds the need for liquidity by commercial handlers hedging price risk in these markets. Section 737 is the result of multi-year consideration by Congress, during which a strong consensus was reached there that excessive speculation by Too Big to Fail banks in commodity derivatives markets is the source of an unnecessary and huge premium paid by consumers worldwide to bolster casino-like betting on commodity price direction.

However, the proposed rules are so weak that they defy the Congressional intent. Specifically, the proposed limits on big bank speculation are so high that they will have no meaningful effect on limiting speculation, leading to wholly unnecessary price volatility and unpredictability in commodity staples. Moreover, the proposed big bank exemption from speculative limits must be removed from the final rule, because it enshrines the Too Big to Fail financial institutions' casino-like atmosphere where passive wealthy investors and institutions are encouraged for a handsome bank transaction fee to do nothing more than gamble on the future price of commodities.

The “cost/benefit” analysis here is simple. If the Commission follows the plain language of Dodd-Frank and its legislative intent, it will, by harnessing excessive speculation, ban gambling on the price direction of critical commodity staples that contributes nothing to commodity production, yet plays havoc in unmooring the price of food and energy from market fundamentals.

The Recent Surge in Commodity Prices Has Tolloed On the Global Economic Recovery and Imposed a Serious Threat on the Lives of People from Third World Countries

In recent months as the effects of the Great Recession drag on, the personal finances of most American consumers, workers, and retirees have taken a serious beating because of destabilizing price spikes in traditional physical commodities, such as oil, gasoline, heating oil,

¹ Position Limits for Derivatives, 76 Fed. Reg. 4752 (January 26, 2011) [hereinafter “Proposed Rules”].

² Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

and basic food staples.³ As one prime example, we have seen uncontrollable volatility in crude oil prices during the last two years: with no substantial underlying change in supply and demand, the price of crude increased from \$40 per barrel in March 2009 to \$80 in March 2010 and to \$105 in March 2011.⁴ During the same time, the world oil demand increased by 4.3 mb/d.⁵ Notably, the world oil supply increased 4.2 mb/d.⁶ Furthermore, the U.N. Food and Agriculture Organization's economist, Abdolreza Abbassian, recently stated: "In terms of price levels internationally I think the situation is certainly getting closer to the levels that we had seen (in 2007/2008)."⁷ He further added that although wheat and rice are so far fairly balanced, increasing food price volatility was *alarming* and could *threaten future food security*.⁸

A report from the United Nations Special Rapporteur on the Right to Food has stated: "The 2008 food price crisis was unique in that... it was characterized by massive amounts of novel forms of speculation in commodity derivative markets."⁹ This food crisis has caused a devastating impact on other countries. Catholic Missionary David Kane of Maryknoll Lay Missioners Office of Global Concerns, who has a leadership role in coordinating worldwide hunger relief organizations relating to excessive speculation, recently stated: "Whatever happens to the recovery at home, soaring food prices appear certain to drive the global poor deeper into destitution this year."¹⁰ He further noted, "[People from third world countries are] used to living on very little, and the fact that spontaneous food riots broke out all over the world demonstrates how desperate things got in 2008, and how desperate they are now."¹¹

³ See Sylvia Pfeifer, *Rising Oil Price Threatens Fragile Recovery*, FIN. TIMES, Jan. 4, 2011, available at <http://www.ft.com/cms/s/0/056db69c-1836-11e0-88c9-00144feab49a.html#axzz1HWnvr4xg> (quoting Fatih Birol, Chief Economist, International Energy Agency: "Oil prices are entering a dangerous zone for the global economy.... The oil import bills are becoming a threat to the economic recovery. This is a wake-up call to the oil consuming countries and to the oil producers."). See also Alejandro Barbajosa, *Oil Price Volatility to Increase in 2011 - HSH Nordbank*, REUTERS, Jan. 6, 2011, available at <http://uk.reuters.com/article/idUKTRE70521U20110106> (quoting Sintje Diek, Oil Analyst, HSH NordBank: "The economic development is not so bad this time and the recovery will continue, but it will not be so dynamic. At the moment, oil prices are too high for this kind of economic environment.").

⁴ Price data for Cushing, OK WTI Spot Price FOB (Dollars per Barrel), ENERGY INFORMATION ADMINISTRATION, available at <http://tonto.eia.doe.gov/dnav/pet/hist/rwtcd.htm>.

⁵ See International Energy Agency, Oil Market Report (Feb. 10, 2011), available at http://omrpublic.iea.org/World/Wb_all.pdf.

⁶ See International Energy Agency, Oil Market Report 31-32 (Feb. 10, 2011), available at <http://omrpublic.iea.org/omrarchive/10feb11full.pdf> (the world oil supply data is only available through January 2011).

⁷ Svetlana Kovalyova, *Food prices near '08 levels, supply stronger*, REUTERS NEWS (Nov. 2, 2010).

⁸ *Id.* (emphasis added).

⁹ OLIVIER DE SCHUTTER, UN SPECIAL RAPPORTEUR, FOOD COMMODITIES SPECULATION AND FOOD PRICE CRISES, September 2010, available at http://www.materialien.org/agrar/20102309_un.pdf.

¹⁰ Zach Carter and Ryan Grim, *Gambling On Hunger: Is Wall Street Fueling Global Unrest?*, HUFFINGTON POST (Feb. 23, 2011), available at http://www.huffingtonpost.com/2011/02/15/gambling-on-hunger-food-crisis-regulators_n_823725.html.

¹¹ *Id.*

According to the IHS Global Insight study, “a \$10 rise in the price of a barrel [of oil] fully passed through will raise the pump price of gasoline by about 24 cents [, which will result in] an extra gasoline spending bill [by U.S. consumers] of \$29.6 billion.”¹²

As this country struggles to emerge from the worst financial crisis since the Great Depression, the recent run up in basic commodity staple prices presents a dire threat that the financial stability of the United States and world economy will reach its breaking point and that we will plunge back into a double-dip recession with no safety net. This time there will certainly be no bailouts or stimulus package to provide the economy with a soft landing.

Indeed, as universally predicted in September 2008 without TARP and stimulus, the U.S. economy would have been headed into a Second Great Depression. Further price spikes in everyday necessities will tank any potential economic recovery, leading to further and more sustained economic hardship for the already financially overburdened American taxpayer, consumer, worker, and retiree.

In light of this, the Commission’s effort to implement speculative position limits in order to bring transparency to the markets and to stabilize the commodities prices warrants strong support and careful adherence is needed not only to the clear Congressional mandate pertaining to this issue, but to the overwhelming support for control of excessive speculation in the studies and reports relating to this subject.

Moreover, imposition of position limits is almost risk free. Position limits ensure liquidity to futures markets, thereby sustaining commercial hedgers for whom the markets have been statutorily created. Similarly, they are designed to blunt *excessive* speculation, *i.e.*, speculation that goes beyond the provision of liquidity. Blocking speculation of that kind is merely the stopping of a casino-like atmosphere, *i.e.*, betting on the upward direction of commodity staples. Stopping that kind of passive betting, which adds nothing to production of energy or food, is identical to closing down betting parlors. It would have an infinitesimal effect on the real economy. Too little attention has been paid to the virtually riskless act of stopping excessive commodity gambling.

U.S. Congress Mandates the CFTC to Impose Strong Position Limits

The Dodd-Frank Act requires the Commission to follow the provisions of that statute, which amends various sections of the Commodity Exchange Act.¹³ The fundamental purpose of the CEA is “to insure fair practice and honest dealing on the commodity exchanges and to provide a measure of control over those forms of speculative activity which *too often demoralize the markets to the injury of producers and consumers and the exchanges themselves.*”¹⁴ Indeed, President Roosevelt, when introducing what became the CEA in 1934, said: “[I]t should be our national policy to restrict, as far as possible, the use of these exchanges for *purely speculative*

¹² Nigel Gault, *Oil Prices and the U.S. Economy: Some Rules of Thumb*, IHS GLOBAL INSIGHT, Feb. 24, 2011, available at <http://www.ihsglobalinsight.com/Perspective/PerspectiveDetail19936.htm>.

¹³ 7 U.S.C. § 1 et seq. [hereinafter “CEA”].

¹⁴ Report No. 421, U.S. House of Representatives 74th Cong, Accompanying the Commodity Exchange Act, March 18, 1935 (emphasis added).

operations.”¹⁵ In this regard, the House Agriculture Committee also stated: “This bill authorizes the Commission . . . to fix limitations upon purely speculative trades . . .”¹⁶

Section 737 of the Dodd-Frank Act pertaining to position limits was created with a goal that is wholly consistent with the CEA, but it requires the CFTC to strengthen position limits to cover all derivatives markets. Section 737 emphatically provides that the Commission “shall by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than bona fide hedge positions that may be held by any person[.]”¹⁷ The language could not be clearer. The Commission is *required to establish position limits* as Congress intentionally used the word, “shall,” to impose the mandatory obligation. According to the CRS Report for Congress on Statutory Interpretation, “[u]se of ‘shall’ and ‘may’ in statutes also mirrors common usage; ordinarily ‘shall’ is mandatory and ‘may’ is permissive.”¹⁸

This congressional intent is bolstered by the fact that the word, “shall,” replaced the word “may” in the House version of the Dodd-Frank Act, then titled, “The Wall Street Reform and Consumer Protection Act of 2009.”¹⁹ In particular, when the House version of the bill was introduced on December 2, 2009, Section 3113 on Position Limits stated: “The Commission *may*, by rule or regulation, establish limits (including related hedge exemption provisions) on the aggregate number or amount of positions in contracts based upon the same underlying commodity (as defined by the Commission) that may be held by any person, including any group or class of traders[.]”²⁰ However, when the House passed the bill by 223 to 202 on December 11, 2009, the word, “may” was replaced with “shall” pursuant to the former House Agriculture Committee Chairman Collin Peterson’s amendment. During the floor debate, Congressman Peterson said “the amendment strengthens confidence in trader position limits on physically deliverable commodities as a way to prevent excessive speculative trading.”²¹ In doing so, he has indicated that it was his intention to strengthen the position limits by imposing on the Commission the mandatory obligation to adopt strong position limits. This amendment has been incorporated into the bill, survived the conference negotiations, and was eventually enacted into law.

Other members of Congress share the same view that the CFTC has a mandatory obligation pursuant to the Dodd-Frank Act to impose position limits. Senator Maria Cantwell, a particularly active legislator on the question of position limits, announced her support for the final version of the legislation on July 1, 2010, ensuring at that time that there would be 60 votes

¹⁵ President Franklin D. Roosevelt, Message to Congress, February 9, 1934 (emphasis added).

¹⁶ Report No. 421, *supra* note 14 (emphasis added).

¹⁷ Dodd-Frank Act, *supra* note 2, §737.

¹⁸ YULE KIM, CRS REPORT FOR CONGRESS, STATUTORY INTERPRETATION: GENERAL PRINCIPLES AND RECENT TRENDS CRS-9 n. 38, August 31, 2008, *available at* <http://www.fas.org/sgp/crs/misc/97-589.pdf> (citing federal case law: “The mandatory ‘shall’ . . . normally creates an obligation impervious to judicial discretion.” *Lexecon, Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35 (1998). “The use of a permissive verb — ‘may review’ instead of ‘shall review’ — suggests a discretionary rather than mandatory review process.” *Rastelli v. Warden, Metro. Correctional Center*, 782 F.2d 17, 23 (2d Cir. 1986)).

¹⁹ The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. (2009).

²⁰ *Id.* (emphasis added).

²¹ Official website of House Committee on Agriculture, House Passes Peterson-Frank Amendment to Strengthen Regulation of Over-the-Counter Derivatives, December 10, 2009, *available at* <http://democrats.agriculture.house.gov/press/PRArticle.aspx?NewsID=207>.

in favor of final passage of the Act, thereby ensuring cloture. She stated: “[T]he *conference report mandates aggregate position limits* across all exchanges[.] The conference report *directs the CFTC to use position limits* to diminish, eliminate, or prevent excessive speculation, disrupt market manipulation, and ensure price discovery is not disrupted.”²²

Furthermore, the usage of both “shall” and “may” in the same provision “underscore[s] their different meanings.”²³ Specifically, the provision states “the Commission *shall* by rule, regulation, or order establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that *may* be held by any person [...]”²⁴ As such, the legislative intent to impose the mandatory obligation to adopt position limits is clearly shown.

The CFTC is Required to Impose Position Limits Prophylactically

The plain reading of §737 reveals that the phrase “as appropriate” modifies only those position limits mandated to be imposed, *i.e.*, the mandatory position limits must be promulgated “as appropriate.” The term “as appropriate” does not modify the heavily emphasized mandate that there “shall” be position limits. The emphasis of certain commenters in opposition to the creation of position limits that the words “as appropriate” make the imposition of limits wholly discretionary is contrary to the plain language of the statute and its legislative history. In short, speculator opponents of position limits want to put the worked “may” back into the statute when that discretionary language was expressly and emphatically removed.

Moreover, speculator opposition to imposition of position limits read into the phrase “as appropriate” that the Commission can impose position limits *only* after the Commission “conduct[s] a complete analysis of the swap market data.”²⁵ Not only does this interpretation run contrary to legislative intent, it also contradicts other sections of the Dodd-Frank Act for the following two reasons.

First, Dodd-Frank requires the Commission to set limits to, *inter alia*, diminish, eliminate, or *prevent* excessive speculation and to *deter and prevent* market manipulation, squeezes, and corners.²⁶ In other words, the purpose of position limits is not to punish past wrongdoing, but rather to deter and prevent potential future dysfunctions in the commodity staples derivatives markets. Because the purpose of position limits is to prevent future violations, the Commission should not be required to appreciate the complete and precise level of excessive speculation *prior* to taking action – an action made impossible by the jurisdictional

²² Press Release, Official Website of Senator Maria Cantwell, Cantwell Announces Support For Regulatory Reform Legislation, July 1, 2010, *available at* <http://cantwell.senate.gov/news/record.cfm?id=326165> (emphasis added).

²³ YULE KIM, CRS REPORT FOR CONGRESS, STATUTORY INTERPRETATION: GENERAL PRINCIPLES AND RECENT TRENDS, August 31, 2008, *available at* <http://www.fas.org/sgp/crs/misc/97-589.pdf> (citing federal case law: “Congress’ use of the permissive ‘may’ ... contrasts with the legislators’ use of a mandatory ‘shall’ in the very same section.” *Lopez v. Davis*, 531 U.S. 230, 241 (2001). “[I]n the law to be construed here it is evident that the word ‘may’ is used in special contradistinction to the word ‘shall.’” *United States ex rel. Siegel v. Thoman*, 156 U.S. 353, 359-60 (1895)).

²⁴ Dodd-Frank Act, *supra* note 2, § 737 (emphasis added).

²⁵ *See, e.g.*, Statement of Jill E. Sommers, Commissioner, Commodities Futures Trading Commission, Open Meeting on the Ninth Series of Proposed Rulemakings under the Dodd-Frank Act, January 13, 2011, *available at* <http://www.cftc.gov/pressroom/speechestestimony/sommersstatement011311.html>.

²⁶ Dodd-Frank Act, *supra* note 2, § 737 (emphasis added).

limits previously imposed upon the CFTC (and the rest of the federal government) by many factors emanating from the deregulation regime put in place by the Commodity Futures Modernization Act²⁷. Because the CFTC previously had no jurisdiction over swaps, it was never properly equipped to comprehend the exact level of excessive speculation across all derivatives markets. It is only with the passage of Dodd-Frank that the Commission now has broad authority to collect data in the swaps markets.

Second, a close reading of the legislative intent reveals that the Commission is not required to conduct a thorough study of the *possible effects* of the position limits prior to adopting its final rule on position limits. Rather, Section 719 of the Dodd-Frank Act specifically requires the Commission “to conduct a study of *the effects of the position limits imposed pursuant to the other provisions of this title* on excessive speculation and on the movement of transactions.”²⁸ The Commission is required to submit the report “within 12 months *after* the imposition of position limits pursuant to the other provisions of this title.”²⁹ Why would Congress specifically require the Commission to submit a report after imposing position limits if it had provided by statute (as opponents of position limits mistakenly argue) that the data must be available *before* the position limit rule is finally promulgated? The short answer is that Congress clearly understood the imminent danger excessive speculation and passive betting on price direction had caused by uncontrollable increases in the prices of energy and agricultural commodities. Therefore, the Commission is statutorily obligated to impose the “appropriate” position limits. To reiterate, Mr. Fekrat, Senior Special Counsel at the CFTC, is wholly correct when he stated that “the Commission may *impose position limits prophylactically, based on its reasonable judgment* that such limits are necessary for the purpose of ‘diminishing, eliminating, or preventing’ such burdens.”³⁰

Numerous Studies Have Concluded that Excessive Speculation Has Significant Impact on the Spot Market Price

Because Congress, after years of study and consideration, mandated that the Commission impose position limits, the question whether independent studies support Congress’s mandate is wholly irrelevant. It is not for the Commission to rescind Congress’s mandate based on its own reading of economic analysis. As shown below, however, even if it were relevant, there is overwhelming and impressive support for Congress’s finding that excessive speculation causes intense volatility and upward price pressures on basic commodity staples. One of the fundamental purposes of futures contracts is to provide price discovery in the “cash” or “spot” markets.³¹ Those selling or buying commodities in the “spot” markets rely on futures prices to judge amounts to charge or pay for the delivery of a commodity.³² Since the

²⁷ Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763.

²⁸ Dodd-Frank Act, *supra* note 2, §719 (emphasis added).

²⁹ *Id.*

³⁰ Statement of Bruce Fekrat, Senior Special Counsel, Division of Market Oversight, Proposed Position Limits for Derivatives, December 16, 2010, *available at* <http://www.cftc.gov/pressroom/speechestestimony/fekratstatement121610.html> (emphasis added).

³¹ The Economic Purpose of Futures Markets and How They Work, COMMODITY FUTURES TRADING COMMISSION, <http://www.cftc.gov/ConsumerProtection/EducationCenter/economicpurpose.html>.

³² See Platts Oil Pricing and Market-on-Close Methodology Explained, Platts (July 2007) at 3, *available at* <http://www.platts.com/IndustrySolutionPapers.aspx>.

creation of futures contracts in the agricultural context decades ago, it has been widely accepted that excessive speculation undermines the price discovery function of the futures markets.³³ This distortion of economic fundamentals is otherwise manifested by unnecessary and substantial price increases that consumers around the world pay for energy, especially crude oil and other everyday consumer staples.

Those who oppose position limits regularly argue that there is a lack of empirical data demonstrating that excessive speculation has unnecessarily and dramatically increased the price of energy and agricultural commodities. For example, Terry Duffy of the CME Group stated during the March 3, 2011 hearing before the Senate Committee on Agriculture, Nutrition and Forestry that “there’s been absolutely no evidence that [speculators] have anything to do with the effect of price whether it comes from an academic, whether it comes from a government study or anything else. So just want to put that clear.”³⁴ This is simply totally and completely incorrect.

As recently as February 24, 2011, the Commodity Markets Oversight Coalition³⁵ to wide fanfare released a list of over 50 studies showing the adverse effects of speculation on energy and food prices.³⁶ In particular, this list includes, *inter alia*, studies from many of the nation’s most prominent academics from Stanford, Texas A&M, MIT, Rice, University of London,

³³ See, e.g., Jonathan Ira Levy, *Contemplating Delivery: Futures Trading and the Problem of Commodity Exchange in the United States, 1875-1905*, AMERICAN HISTORICAL REVIEW 307 (2006) (quoting *Fictitious Dealings in Agricultural Products: House Comm. on Agric. Committee Hearing Reports* (1892): “[T]he man who managed or sold or owned those immense wheat fields has not as much to say with the regard to the price of the wheat that some young fellow who stands howling around the Chicago wheat pit could actually sell in a day.”).

³⁴ See *Transcript of Implementation of Title VII of the Wall Street Reform and Consumer Protection Act, Hearing Before the Senate Committee on Agriculture, Nutrition & Forestry*, 112th Cong. (March 3, 2011) (Statement of Terry Duffy, Executive Chairman, CME Group). See also Jim Spencer and Dee DePass, *As we pay more at the pump, oil trading curbs still on hold*, STAR TRIBUNE (March 20, 2011) (quoting Tom LaSala, Chief Regulatory Officer, CME Group: “There is no empirical evidence that excessive speculation has affected prices.”).

³⁵ The Commodity Markets Oversight Coalition is an independent, non-partisan and non-profit alliance of groups that represents commodity-dependent industries, businesses and end-users, including average American consumers, that rely on functional, transparent and competitive commodity derivatives markets as a hedging and price discovery tool. Official Website of Commodity Markets Oversight Coalition, What is the Commodity Markets Oversight Coalition (CMOC)?, available at <http://commoditymarketoversight.org/>.

³⁶ See Official Website of Commodity Markets Oversight Coalition, Studies On Speculation, available at <http://commoditymarketoversight.org/> (last visited on March 17, 2011).

Princeton, and NYU,³⁷ well-known economists,³⁸ market participants,³⁹ and bipartisan Congressional reports⁴⁰ showing that unchecked excessive speculation leads to dysfunctions in commodity market pricing mechanisms. As recently as March 23, 2011, Stanford Professor

³⁷ DAVID P. ANDERSON, TEXAS A&M UNIVERSITY AGRICULTURAL & FOOD POLICY CENTER, THE EFFECTS OF ETHANOL ON TEXAS FOOD AND FEED (Apr. 10, 2008), <http://www.afpc.tamu.edu/pubs/2/515/RR-08-01.pdf> (“Speculative fund activities in futures markets have led to more money in the markets and more volatility. Increased price volatility has encouraged wider trading limits. The end result has been the loss of the ability to use futures markets for price risk management due to the inability to finance margin requirements.”); R.S. ECKAUS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY CENTER FOR ENERGY AND ENVIRONMENTAL POLICY RESEARCH, THE OIL PRICE REALLY IS A SPECULATIVE BUBBLE (June 2008), <http://www.cii.org/UserFiles/file/oil%20prie%20is%20spec%20bubble%20-%20MIT%20study%20-%20June%202008.pdf>; MICHAEL GREENBERGER, THE RELATIONSHIP OF UNREGULATED EXCESSIVE SPECULATION TO OIL MARKET PRICE VOLATILITY (Jan. 15, 2010), <http://www.michaelgreenberger.com/files/IEF-Greenberger-AppendixVII.pdf>; KENNETH B. MEDLOCK III & AMY MYERS JAFFE, RICE UNIVERSITY JAMES A. BAKER III INSTITUTE FOR PUBLIC POLICY, WHO IS IN THE OIL FUTURES MARKET AND HOW HAS IT CHANGED? (Aug. 26, 2009), <http://www.rice.edu/energy/publications/docs/MedlockJaffeOilFuturesMarket-082609-1.pdf>; MACHIKO NISSANKE, UNIVERSITY OF LONDON SCHOOL OF ORIENTAL AND AFRICAN STUDIES, COMMODITY MARKETS AND EXCESS VOLATILITY: SOURCES AND STRATEGIES TO REDUCE ADVERSE DEVELOPMENT IMPACTS, (Nov. 2010), http://www.cfc-brussels.org/pdf/1102251406_Prof.%20Nissanke%20-%20CFCPaperNOV-2010.pdf; L. RANDALL WRAY, THE LEVY ECONOMICS INSTITUTE OF BARD COLLEGE, THE COMMODITIES MARKET BUBBLE: MONEY MANAGER CAPITALISM AND THE FINANCIALIZATION OF COMMODITIES (2008), http://www.levyinstitute.org/pubs/ppb_96.pdf; KE TANG (PRINCETON) AND WEI XIONG (RENMIN UNIVERSITY OF CHINA), INDEX INVESTMENT AND FINANCIALIZATION (March 2011), available at <http://www.princeton.edu/~wxiong/papers/commodity.pdf>; Nouriel Roubini, *The risk of a double-dip recession is rising*, FIN TIMES (Aug. 23, 2009), available at <http://www.ft.com/cms/s/0/90227fdc-900d-11de-bc59-00144feabdc0.html#axzz1HWNA8CxK>.

³⁸ *Regulatory Reform Hearing Before the Cong. Oversight Panel*, 111th Cong. (2009) (testimony of Joseph E. Stiglitz) (arguing that only standardized and regulated products used for hedging against risk, but not “gambling,” should be permitted), available at <http://cop.senate.gov/documents/testimony-011409-stiglitz.pdf>; Alan S. Blinder, *The Two Issues to Watch on Financial Reform - We need an independent consumer watchdog and strong derivatives regulation. Industry lobbyists are trying to water them down*, WALL ST. J. (April 22, 2010), available at <http://online.wsj.com/article/SB10001424052748704133804575197852294753766.html>; *Written Statement of James K. Galbraith, Before the Financial Crisis Inquiry Commission* (June 30, 2010), available at <http://www.newdeal20.org/wp-content/uploads/2010/06/deficitcommissionrv.pdf>.

³⁹ Richard Branson, Michael Masters & David Frenk, Letter to the Editor, *Swaps, Spots and Bubbles*, THE ECONOMIST, July 29, 2010, available at http://www.economist.com/node/16690679?story_id=16690679&CFID=162683712&CFTOKEN=35576411 (assertion from executives of the Virgin Group, Masters Capital Management, and Better Markets, Inc.: “There is strong evidence that speculation exacerbated the last oil and food bubble. Speculation will fuel the next one too, unless meaningful speculative position limits are established.”).

⁴⁰ STAFF OF S. PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, 111TH CONG., EXCESSIVE SPECULATION IN THE WHEAT MARKET (June 24, 2009) (“This Report concludes there is significant and persuasive evidence that one of the major reasons for the recent market problems is the unusually high level of speculation in the Chicago wheat futures market due to purchases of futures contracts by index traders offsetting sales of commodity index instruments.”); STAFF OF S. PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, 110TH CONG., EXCESSIVE SPECULATION IN THE NATURAL GAS MARKET, (June 25 & July 9, 2007); STAFF OF S. PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, 109TH CONG., THE ROLE OF MARKET SPECULATION IN RISING OIL AND GAS PRICES: A NEED TO PUT THE COP BACK ON THE BEAT, (June 27, 2006) (“The large purchases of crude oil futures contracts by speculators have, in effect, created an additional demand for oil, driving up the price of oil to be delivered in the future in the same manner that additional demand for the immediate delivery of a physical barrel of oil drives up the price on the spot market.”).

Kenneth Singleton has released a study demonstrating a positive correlation between the commodity index fund positions and the oil prices.”⁴¹

Here, the Commission should note the expert analysis of industry participants that the current oil price does not reflect market fundamentals. For example, the chief counsel at one of the largest airlines, Delta Air Lines, recently stated that “the marginal cost of oil production is now \$60 to \$70 a barrel,”⁴² compared to the current WTI price of \$105 as of March 22, 2011.

Whatever debate remains over the question whether excessive speculation significantly impacts price volatility should be put to rest completely by the last of a series of three bipartisan staff reports of the Senate Permanent Subcommittee on Investigations (“PSI”), which on June 24, 2009 (with the express endorsement of both PSI Chair Senator Carl Levin and Ranking Member Senator Tom Coburn)⁴³ demonstrated conclusively that:

- “[o]ver the past four years ... increases in wheat prices were nearly as steep as the increases in the price of oil,”⁴⁴ during which period wheat prices rose “to record heights”;⁴⁵
- there is “significant and persuasive evidence that the large number of wheat futures contracts (long open interest) held by commodity index traders is a primary reason for the pricing problems in the wheat market ... including ... the disconnect between wheat futures prices and cash market fundamentals ... during 2008”;⁴⁶
- “commodity index instruments were, in essence, *speculative bets*”;⁴⁷ and
- “[t]he total value of the *speculative* investments in commodity indexes has increased an estimated tenfold in five years, from an estimated \$15 billion in 2003, to around \$200 billion by mid-2008.”⁴⁸

Investments in commodity indexes are “purchased mainly by financial institutions, insurance companies, pension funds, foundations, hedge funds and wealthy individuals[.]”⁴⁹ The purchases of these index instruments have resulted in the injection of billions of dollars in

⁴¹ KENNETH J. SINGLETON, GRADUATE SCHOOL OF BUSINESS PROFESSOR, STANFORD UNIVERSITY, INVESTOR FLOWS AND THE 2008 BOOM/BUST IN OIL PRICES (March 23, 2011), available at <http://www.stanford.edu/~kenneths/>.

⁴² Jim Spencer and Dee DePass, *As we pay more at the pump, oil trading curbs still on hold*, STAR TRIBUNE (March 20, 2011) (quoting Ben Hirst, Chief Counsel, Delta Air Lines: “[S]peculators try to anticipate what other speculators are going to do, and the market overreacts. It’s not as though there’s a shortage of product that caused the price to move up. It’s a casino process with financial players betting on where the price is going to go. But it has an effect on [current] prices.”).

⁴³ See Press Release, Sen. Carl Levin, Investigations Subcommittee Releases Levin-Coburn Report on Excessive Speculation in the Wheat Market (June 24, 2009), available at <http://levin.senate.gov/newsroom/release.cfm?id=314947>.

⁴⁴ PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, EXCESSIVE SPECULATION IN THE WHEAT MARKET 37 (June 24, 2009) [hereinafter “Wheat Report”].

⁴⁵ *Id.* at 39.

⁴⁶ *Id.* at 120.

⁴⁷ *Id.* at 94 (emphasis added).

⁴⁸ *Id.* at 5 (emphasis added).

⁴⁹ *Id.* at 76.

passive, long investments into the agricultural, energy, and metals futures markets.”⁵⁰ Recently, CFTC Commissioner Chilton stated: “Hedge funds and other speculators have increased their positions in energy markets by 64 percent since June 2008 to the highest level on record.”⁵¹ He further stated: “Between June of 2008 and January of 2011, futures equivalent contracts held by these types of speculators increased 64 percent in energy contracts. In June of 2008, the number of such contracts totaled 617,000. By September of 2010, they were 923,000. And, by January of this year, they had grown to 1,011,000.”⁵² Without imposing timely and effective position limits, the numbers of contracts held by these speculators will continue to increase, while more American workers, consumers and retirees face unreasonably and unwarranted high commodity prices.

Position Limits Will Reduce Price Volatility and Unpredictability

The tension between commercial producers and consumers trying to achieve fair prices for the sale and/or purchase of physical commodities through the public transparent hedging process moors these price discovery futures markets to economic fundamentals and, correspondingly, ensures fair market prices to the ultimate consumers of these commodities.

Speculators are indeed part of the market. They have a role to play in the hedging function *when* they are needed to ensure that the market has liquidity. However, speculators’ motivations do not include ensuring fair prices. Rather, they are simply betting on the direction of the market and their sole interest is that the markets go as high or as low as possible in support of their betting strategy. To the extent the speculator is providing liquidity for physical hedgers, the speculator is serving a public interest by assisting in the hedging function. In this sense, “speculators provide a buffer.”⁵³ When speculation is “excessive,” however, those market “bets,” as shown in the bi-partisan Wheat Report described above, unmoor the market from fundamentals and, correspondingly, drive the hedger from the markets because of volatility and unpredictability. This is not a matter of having “no buffer capacity,”⁵⁴ but rather having an unnecessarily large buffer that is upending the commodity derivatives markets.

It is the historic purpose of position limits to draw a line between the speculation that is needed to create liquidity for commercial hedgers and the speculation that unmoors markets from price fundamentals, requiring consumers worldwide to put money in the hands of those who have no role in the production of the underlying commodities.

⁵⁰ *Id.* at 76 (emphasis added).

⁵¹ Silla Brush, *Hedge Fund Energy Speculation Highest on Record, CFTC’s Bart Chilton Says*, BLOOMBERG, March 15, 2011, available at <http://www.bloomberg.com/news/2011-03-15/hedge-fund-energy-speculation-highest-on-record-cftc-s-bart-chilton-says.html>.

⁵² Keynote Address of Commissioner Bart Chilton to the 13th Annual Structured Trade and Finance in the Americas Conference, Interconnectedness, March 15, 2011, available at <http://www.cftc.gov/pressroom/speechestestimony/opachilton-40.html>.

⁵³ Jim Spencer and Dee DePass, *As we pay more at the pump, oil trading curbs still on hold*, Star Tribune (March 20, 2011) (quoting David Kreutzer, Energy Economist, Heritage Foundation).

⁵⁴ *Id.*

It is widely understood that “increasing volatility makes it more expensive for producers and consumers to use futures as a hedge.”⁵⁵ If commercial interests cannot hedge in a fair and orderly market, they and their ultimate consumers, the public at large, are left to the mercy of volatile markets that undercut the hedging function. One needs to look no further than the airline industry to realize that a lack of effective position limits had a “huge impact on airlines.”⁵⁶ Some of the world’s largest airlines have said that out of control volatilities in the oil prices is “a kind of silent killer.”⁵⁷ The latest problem has to do with the costs associated with locking in fuel prices for a year. According to Professor Anderson, the price volatility has caused “the loss of the ability to use futures markets for price risk management due to the inability to finance margin requirements.”⁵⁸ At least one consultant thinks the industry should stop hedging outright and handle volatile fuel prices with surcharges.⁵⁹

A contract market dominated by speculators changes the market from one that constructively hedges risk to ensure pricing based on market fundamentals into a casino-like atmosphere consisting of bets on market direction unmoored from real world market responsibilities. One of the main benefits of position limits is to prevent sudden or unreasonable fluctuations or unwarranted changes in the price of commodities. In other words, the position limits are designed to minimize the price volatilities, therefore stabilizing the commodity prices. When there is less volatility in price, the cost of hedging will necessarily decrease.

Finally, creating position limits has no meaningful adverse affect on the real economy. Position limits are designed to permit sufficient speculation to afford liquidity to commercial users of derivatives markets. They also limit the scope of gambling – for gambling’s sake – on upward price directional bets on energy and food staples worldwide. Stopping *excessive* gambling will not undercut production one whit. It will cause no economic pain except to the too big to fail casinos, including the world’s biggest futures exchange, who want to create profits off the backs of the American consumer, worker and retiree.

The cost benefit analysis here is quite simple. By stopping unproductive gambling by passive wealthy investors that exceeds the provision of liquidity, consumers here and worldwide will pay fair, market driven prices for their everyday needs.

⁵⁵ Mark Shenk, *West Texas Crude Losing Status as Global Benchmark for Oil: Energy Markets*, BLOOMBERG, Sept. 24, 2010, available at <http://www.bloomberg.com/news/2010-09-23/west-texas-crude-losing-status-as-global-benchmark-for-oil-energy-markets.html>.

⁵⁶ Mary Jane Credeur, Mary Schlangenstein and Paul Burkhardt, *United, Delta Profit at Risk on ‘Silent Killer’ Hedges*, BLOOMBERG, January 31, 2011, available at <http://www.bloomberg.com/news/2011-01-31/united-delta-profit-at-risk-from-silent-killer-in-fuel-hedges.html>.

⁵⁷ *Id.*

⁵⁸ See Anderson, *supra* note 37.

⁵⁹ Mary Jane Credeur, Mary Schlangenstein and Paul Burkhardt, *United, Delta Profit at Risk on ‘Silent Killer’ Hedges*, BLOOMBERG, January 31, 2011, available at <http://www.bloomberg.com/news/2011-01-31/united-delta-profit-at-risk-from-silent-killer-in-fuel-hedges.html> (quoting Hunter Keay, Analyst at Stifel Nicolaus & Co.: “If this industry all stopped hedging, there would be a much more rational pricing environment.”).

The Proposed Levels on Speculation Are So High That They Will Have No Meaningful Effect On Limiting Destabilizing Price Volatility in Basic Commodity Staples

In this vein, the proposed position limits rules are so lax as to be virtually meaningless in driving excessive speculation from the markets. At best, they permit the excessive speculation that now exists and now distorts prices with the mere *possibility* of limiting future increased speculation. That result defies Congressional intent and asks consumers worldwide to grant a further hidden subsidy to Too Big to Fail Banks and futures exchanges with the provision of absolutely no contribution to increased production.

Proposed §151.4 would impose position limits for physical delivery contracts.⁶⁰ For implementation of the proposed rules, two stages are prescribed. First, the CFTC would enforce spot-month limits by setting position limits at 25 percent of estimated deliverable supply. During the second phase, the CFTC would impose position limits for non-spot-month contracts based on open interest on a particular referenced contract. Under a formula proposed by the Commission, non-spot-month position limits will be set for each referenced contract at 10 percent of open interest in that contract up to the first 25,000 contracts, and 2.5 percent thereafter.

However, these levels are so high that they will have no meaningful effect on excessive speculation. According to Ben Hirst, a general counsel at Delta Air Lines, the CFTC's currently proposed limit on speculative position – 25 percent of available supply – is far too high and “[they] are not proposing to adopt rules that will have any effect on speculation[.] They are only making sure no one can corner the market.”⁶¹ In other words, while the proposed levels may be effective to prevent market manipulation, they are insufficient to prevent the wholly separate statutory objective of stopping *excessive speculation*, which requires no showing of intent; but, nevertheless in the aggregate constrains market fundamentals.

For example, in order to corner the market, one might need to control the *majority* of the available supply for that commodity. However, one would not need to control the majority of available supply to engage in excessive speculation. Aggregate betting on the price direction of commodities by many speculators can, without any intent, destabilize markets. The CEA defines “excessive speculation” as any commodity under contracts of sale “causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity.”⁶² Therefore, speculative betting that exceeds that needed to create liquidity for commercial handlers causes price changes that defy market fundamentals of supply and demand and has been historically banned as excessive speculation.

It must therefore be remembered that manipulation of markets which evidences intent of wrongdoing is completely different from excessive speculation which can occur by flooding of the market by thousands of passive price directional bettors who destroy the market without necessarily any adverse intent.

⁶⁰ See Proposed Rules, *supra* note 1.

⁶¹ Jim Spencer and Dee DePass, *As we pay more at the pump, oil trading curbs still on hold*, STAR TRIBUNE (March 20, 2011).

⁶² See 7 U.S.C. § 6a.

In the proposal, the Commission fails to clearly distinguish between market manipulation and excessive speculation. In particular, the provided justification for the proposed spot-month position limits is: “The formula seeks to minimize the potential for corners and squeezes by facilitating the orderly liquidation of positions.”⁶³ This justification is only valid for preventing market manipulation, not excessive speculation. In order to achieve the goal of preventing excessive speculation and to satisfy the wholly separate statutorily mandated regulatory tool of position limits, the Commission must reconsider whether the proposed levels are sufficient to prevent “excessive speculation” in the marketplace as a whole. By ignoring the legislative mandate for position limits, which goes all the way back the 1936 CEA, the Commission in its proposed rule has written out all concern for excessive speculation. That defies the most clear Congressional intent and would, if finalized, be a flat violation of the statute.

More appropriate position levels should be set to ensure that the position limits would serve to prevent excessive speculation and to ensure that the price discovery function of the market is not disrupted by the speculators. To achieve this, the Commission should set the position levels at five percent of open interest up to the first 25,000 contracts, and 2.5 percent thereafter across all markets. This formula is similar to the one that was proposed by Michael Masters during the March 25, 2010 testimony before the Commission. He suggested: “No single non-commercial entity should ever be allowed to represent more than 5 [percent] of a market’s total open interest under any circumstances.”⁶⁴ However, in order to accommodate both large open interest and small open interest for different commodities, the 2.5 percent additional flexibility beyond the first 25,000 contracts is acceptable.

Bona Fide Hedging Activities Should Not Include Financial Interests of Swap Dealers

Although the Commission’s proposal to adopt a *bona fide* hedging exemption for traders hedging commercial risks to the extent of their demonstrated needs⁶⁵ merits support, the Commission must impose a strict standard for granting such an exemption. In particular, the proposed rules should not exclude swap dealers’ financial risk management transactions from position limits, which essentially give the Too Big to Fail banks a license to keep their casinos open to wealthy investors for passive bets on the upward direction of commodity staples with no benefit (and indeed great liability) to the American consumer.

In the proposed rules, the Commission relies on a definition from regulation 1.3(z), under which bona fide hedging includes “transactions or positions [that] normally represent a substitute for transactions to be made or positions to be taken at a later time *in a physical marketing channel*, and where they are economically appropriate to the reduction of risks in the conduct and management of a *commercial enterprise*.”⁶⁶ However, the Commission has adopted some of the biggest swap dealers’ and futures exchanges’ arguments and provided exemptions for “products and services similar to [risk management products offered by swap dealers] to qualify

⁶³ Proposed Rules, *supra* note 1, at 4757.

⁶⁴ Written Testimony of Michael Masters, *before the Commodities Futures Trading Commission on Examination of the Trading of Futures and Options in the Precious and Base Metals Markets*, March 25, 2010, available at http://www.nfiactioncenter.com/PDF/masters_testimony_25mar2010.pdf.

⁶⁵ Proposed Regulation 17 C.F.R. §151.3(a)(1).

⁶⁶ *See id.*, at n.49 (citing 17 CFR 1.3(z)(1)) (emphasis added).

as bona fide hedging transactions or positions.”⁶⁷ This would permit swap dealers to continue “to manage the risk of a swap portfolio (*i.e.*, their casino like function of allowing wealthy investors to bet on the upward price of commodity staples) that exists at the time of implementation of the proposed regulations.”⁶⁸ This approach would completely undermine the primary target of the Dodd-Frank position limits provision.

According to the bi-partisan Wheat Report, the CFTC has prior to the passage of Dodd-Frank granted informal and opaque hedging exemptions to four swaps dealers for wheat futures trading on the Chicago futures exchange since 2005. These exemptions allow the dealers to hedge exposure against their commodity index swaps investors. The Report states: “Those exemptions permit the swaps dealers to hold up to 10,000, 17,500, 26,000, and 53,000 wheat futures contracts.”⁶⁹ Adding CFTC staff hedging exemptions granted to ETFs, those “six index traders ... hold a total of up to almost 130,000 wheat futures contracts in any single month and in all months combined” measured against an allowable limit of 39,000 contracts in the absence of the hedge exemptions.⁷⁰ Thus, those six commodity index traders “may have held as much as 60% of the long open interest in” CME wheat futures contracts.⁷¹ The Report further states: “If each swap dealer were restricted to holding no more than 6,500 wheat futures contract at any given time [*i.e.*, limited to the spot month CFTC-established position limit] these swaps dealers would have had to find another way to offset their financial exposure to the commodity index swaps they sold, or to assume the outright risk from those swaps.”⁷²

The bi-partisan Wheat Report concluded that “the activities of the commodity index traders, in the aggregate, constituted ‘excessive speculation’ in the wheat market under the Commodity Exchange Act” and that “the CFTC [must] phase out existing exemptions and waivers that allow some index traders to operate outside of trading limits designed to prevent excessive speculation.”⁷³ In response to the bi-partisan Wheat Report, the CFTC withdrew two no-action letters granting relief from Federal speculative position limits on August 18, 2009.⁷⁴

Recently, Commissioner Dunn stated: “The impact that position limits would have on energy markets is unclear,” noting agricultural futures have been high and volatile since 2007 despite having speculative curbs.⁷⁵ However, agricultural futures markets have been subject to many of the same informal and opaque swap dealer exemptions as has been true of the energy futures markets. Even though the position limits were imposed by the Commission for

⁶⁷ Comment Letter by Colin Bryce, Managing Director, Head of EMEA Sales & Trading, Global Co-Head of Commodities, Morgan Stanley and Simon T.W. Greenshields, Managing Director, Global Co-Head Commodities, Morgan Stanley to David Stawick, Secretary, Commodities Futures Trading Commission, April 25, 2010.

⁶⁸ Proposed Rules, *supra* note 1, at 4763.

⁶⁹ Wheat Report, *supra* note 44, at 105.

⁷⁰ *Id.* at 105.

⁷¹ *Id.* at 106.

⁷² *Id.* at 104, n. 187.

⁷³ *Id.* at 2-3.

⁷⁴ See Press Release, CFTC Withdraws Two No-Action Letters Granting Relief from Federal Speculative Position Limits on Soybeans, Corn and Wheat Contracts, August 19, 2009, available at <http://www.cftc.gov/PressRoom/PressReleases/pr5695-09.html>.

⁷⁵ Roberta Rampton, *INTERVIEW-CFTC's Dunn keeping "open mind" on position limits*, THOMSON REUTERS (March 17, 2011), available at <https://research.tdwaterhouse.ca/research/public/Markets/NewsArticle/1314-N17126652-1>.

agricultural futures and the exchanges for energy futures, they both used the same exemption for swap dealers hedging their casino-like operations. That explains fully why agricultural and energy prices were in a simultaneous bubble from 2004 through 2008 and why they are in a simultaneous bubble now.

As the bipartisan Congressional report recommends, swap dealers hedging their risk from price directional bets by their wealthy customers are the very cause of the commodity bubbles. To grant them a “bona fide hedger” exemption is to ask consumers around the world to pay a speculator’s premium on basic commodity staples that has nothing to do with production of real commodities. This flies in the face of position limits as enacted in 1936 and those broader limits enacted again in 2010 by Dodd-Frank. To allow Too Big to Fail Banks to continue disrupting market fundamentals worldwide would defy what Congress has intended. Commissioners have to decide if they are on the side of the big banks and the big futures exchanges or on the side of the American taxpayer, consumer, worker and retiree.

The Commission must remove the swap dealer’s financial interest exemptions from the final rules, limiting exemptions to businesses that deal in physical commodities and use markets to hedge commercial risk in those commodities.

Exemptions to the Position Limits Should Not Be Permitted Retroactively

The proposed rules would provide “a limited exemption for positions in DCM contracts for future delivery or option contracts that are in excess of a position limit, provided that they were established in good faith prior to the effective date of a position limit set by rule, regulation or order.”⁷⁶ Furthermore, the Commission would provide a blanket exemption from the position limits to “Dodd-Frank Act pre-effective date swaps” because swaps are generally longer lived than futures contracts and thus position limits impacting pre-effective date swaps could unnecessarily disrupt position hedging through swap positions.⁷⁷

However, these exemptions are wholly unjustified. As mentioned above, it has been repeatedly proven that the swap dealer exemptions have allowed those swap dealers to enter into excessive speculative transactions in the wheat market. According to the bi-partisan Wheat Report, “four swap dealers selling index-related swaps currently operate with hedge exemptions that allow them to hold much larger positions on the Chicago wheat futures market than would otherwise apply under the CFTC’s speculative position limits.”⁷⁸ Allowing those exemptions to continue would not only undermine the purpose of position limits, but it would also drive excessive speculation in other commodity markets as well.

Proposed “Estimated Deliverable Supply” Is an Appropriate Basis for Determining Position Limits

In calculating the position limits, the Commission proposed to use “estimated deliverable supply,” which will be determined by the Commission on an annual basis following receipt of an

⁷⁶ Proposed Rules, *supra* note 1, at 4763.

⁷⁷ *Id.*

⁷⁸ See Wheat Report, *supra* note 44.

estimate of deliverable supply by the applicable designated contract market.⁷⁹ This deliverable supply information would not include supplies that “could be procured at *unreasonably high prices* or *diverted from non-standard locations*.”⁸⁰ Also, it would not include supply that is “committed for long-term agreements and would therefore *not be available to fulfill the delivery obligations arising from current trading*.”⁸¹

Some market participants have argued that the proposed position limits would “unfairly exclude certain futures contracts from its definition of available supply, effectively reducing the number of contracts traders can hold.”⁸² However, in calculating the position limits, it is necessary that the deliverable supply reflects the market’s normal and rational behavior in order to capture the most reasonable data. Furthermore, the deliverable data should only capture the “annual” data as the position limits would be imposed on an annual basis. Therefore, excluding delivery obligations that are not arising from the current trading is reasonable. In light of this, the proposed method of calculating deliverable supply warrants strong support since it is designed to weed out irrational and unreasonable data.

Also, the Securities Industry and Financial Markets Association (“SIFMA”) has argued that the Commission should use “available deliverable supply” instead of the proposed “estimated deliverable supply” in calculating the spot-month position limit.⁸³ SIFMA reasons that since available deliverable supply is “supply that can be made readily available for delivery under contract terms[, this historical data] provides a more accurate benchmark.”⁸⁴ However, the SIFMA proposal denies the Commission the necessary regulatory flexibility to offer and rely on its own analysis.

The proposed rule would provide this necessary regulatory flexibility as the Commission would make a final determination after considering “the DCM’s estimate in conjunction with analyzing its own data and reviewing position limit related DCM filings.”⁸⁵ In a market where significant regulatory change is ongoing, the regulatory flexibility authorized under the proposed rule will ensure that the Commission is able to properly respond to ever changing market conditions.

Account Aggregation Proposals Warrant Support

The proposed rule, § 151.7, to establish account aggregation standards specifically for positions in referenced contracts should be included in the final rule. This rule would require that the position limits in referenced contracts be applied to all positions in accounts in which “any trader, directly or indirectly, has an ownership or equity interest of 10 percent or greater or,

⁷⁹ Proposed Rules, *supra* note 1, at 4758.

⁸⁰ *Id.* (emphasis added).

⁸¹ *Id.* (emphasis added).

⁸² See, e.g., Jim Spencer and Dee DePass, *As we pay more at the pump, oil trading curbs still on hold*, STAR TRIBUNE (March 20, 2011) (quoting Tom LaSala, Chief Regulatory Officer, CME Group).

⁸³ See Comment Letter from Conrad Voldstad, Chief Executive Officer, SIFMA to David Stawick, Secretary, Commodity Futures Trading Commission (January 11, 2011).

⁸⁴ *Id.* at 3.

⁸⁵ Proposed Rules, *supra* note 1, at 4758.

controls trading.”⁸⁶ Under the current rules, commodity pool operators, limited partners, and futures commission merchants are not required to aggregate their positions. However, upon adoption, the proposed rule would mandate aggregation of those positions at the pool level. Hence, a trader would have to aggregate positions in multiple accounts or pools, including passively managed index funds, if those accounts or pools have identical trading strategies. This would enable the Commission to effectively monitor and enforce the position limits by preventing a hedge fund from creating multiple mini-hedge funds and hold five times the position limits.

Proposed Position Visibility Requirements Should Be Imposed on Referenced Agricultural Contracts

Proposed § 151.6 would establish position visibility reporting requirements for referenced energy and precious metals contracts. The position visibility is designed to “make the physical and derivatives portfolios of the largest traders in referenced contracts visible to the Commission.”⁸⁷ According to the Proposed Rules, the position visibility regime would “improve the Commission’s ability to monitor the positions of the largest traders ... and the effects on the markets of those large positions.”⁸⁸ If a trader holds or controls positions in referenced contracts that exceed the proposed visibility levels as determined by the Commission, the trader would be required to submit information about “cash market and derivatives activity, including data relating to substantially the same commodity.”⁸⁹

However, the proposed rules do not impose the visibility requirements on referenced agricultural contracts. In doing so, the Commission fails to provide any justification for such exclusion. Under sections 4a and 8a(5) of the CEA, the Commission is statutorily permitted to establish reporting requirements necessary to establish and enforce position limits. Pursuant to this authority, the Commission should impose the visibility requirements on agricultural contracts. During the extensive periods of excessive volatility in agricultural markets, the visibility requirements warrant strong support.

International Regulatory Arbitrage Would Be Minimal

The imposition of position limits has inspired concerns stating in a global market that, “[i]f you restrict them in the United States only, there is going to be some regulatory arbitrage.”⁹⁰ Similarly, some banks have advanced an argument that they will figure out a clever technological way to trade abroad or relocate themselves offshore. However, this is not the case.

⁸⁶ Proposed Rules, *supra* note 1.

⁸⁷ Proposed Rules, *supra* note 1, at 4761.

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ See Michael J. McFarlin, CFTC Sets Limits, FUTURES MAG.COM (Feb. 1, 2011), available at <http://www.futuresmag.com/Issues/2011/February-2011/Pages/CFTC-sets-limits.aspx> (citing Paul Zubulake, Senior Analyst at Aite Group). See also Christopher Johnson and Emma Farge, Analysis: New rules could make oil even more volatile, REUTERS (March 8, 2011), available at <http://www.reuters.com/article/2011/03/08/us-oil-regulation-idUSTRE7271IH20110308?pageNumber=1> (citing Marco Dunand, Chief Executive of Mercuria Energy).

First, Congress in requiring position limits did not say that they should be abandoned if there is a “race to the bottom” among nations.

Second, trading abroad will still fall within U.S. jurisdiction if it has substantial effect on domestic markets.⁹¹ Indeed, U.S. citizens are subject to criminal sanctions if they use foreign exchanges to adversely impact domestic markets and, in most instances, would be extradited back to the U.S. to face criminal or civil charges, if their actions impact domestic markets and have any meaningful contacts with the U.S.⁹²

The alleged international regulatory arbitrage, if any, will have minimal impact for the following three reasons. First, the law is clear on the extraterritorial jurisdictional power of the Commission as granted by Section 722, which amends Section 2 of the CEA, of the Dodd-Frank Act:

The provisions of this Act relating to swaps that were enacted by the Wall Street Transparency and Accountability Act of 2010 (including any rule prescribed or regulation promulgated under that Act), shall not apply to activities outside the United States *unless those activities—*

- (1) *have a direct and significant connection with activities in, or effect on, commerce of the United States; or*
- (2) *contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this Act that was enacted by the Wall Street Transparency and Accountability Act of 2010.*⁹³

If the Commission can demonstrate “direct and significant effect” on the U.S. commerce, under subparagraph (2) above, the CFTC has *complete discretion* to take necessary or appropriate actions to prevent the evasion of any provision of the Dodd-Frank Act.

Third, a person outside the U.S. who engages in swap dealing activities and regularly enters into swaps with U.S. persons would likely be required to register as a swap dealer under new Section 2(i) of the CEA, as amended by Dodd-Frank. As a registered entity, it will be subject to all data reporting requirements as well as other relevant provisions under the Commission’s jurisdiction.

Fourth, other international financial regulatory authorities are working closely with U.S. regulators to implement comparable rules and regulations. It is clear that Middle Eastern,

⁹¹ See Johnson & Hazen, *Derivatives Reg.*, § 4.05[6], at 984 (2004 ed.) (“[E]ven without substantial activity in the United States, jurisdiction will exist [even] when conduct abroad has a substantial effect on U.S. markets or U.S. investors.” (footnotes and citations omitted)).

⁹² See Press Release, Department of Justice, U.S. Charges 47 After Long-Term Undercover Investigation Involving Foreign Exchange Markets (Nov. 19, 2003), *available at* <http://www.fbi.gov/dojpressrel/pressrel03/wooden111903.htm>.

⁹³ Dodd-Frank Act, *supra* note 2, §722.

African, and Asian countries have a greater hostility to the “financialization” of commodity markets than is found here in the U.S.⁹⁴

It should also be noted that many foreign jurisdictions may not be all that hospitable to expatriate Too Big To Fail U.S. banks. The U.K. and other European supporters have proposed, for example, “an overall 15-20 per cent [core tier one capital] ratio”⁹⁵ for systemically risky banks compared to the 7 per cent Basel III standard, the latter of which the U.S. supports. Increasing financial contacts with those jurisdictions would cause banks to incur what they deem as highly unattractive capital charges, not to mention highly unfavorable tax rates.

Therefore, even if Congress had permitted international arbitrage to blunt its mandate of aggregate position limits (which it did not), the only real adverse arbitrage will come from the Commission refusing to impose congressionally mandate position limits, thereby allowing the U.S. to continue as the foremost commodity casino in the world and the country bearing the greatest responsibility for worldwide dysfunctions in soaring commodity prices which have no relationship to market fundamentals. That is certainly not what Congress intended when it enacted Section 737 of the Dodd-Frank Act.

⁹⁴ See Michael Greenberger, *The Relationship of Unregulated Excessive Speculation to Oil Market Price Volatility*, in REPORT OF THE EXPERT GROUP AS CONVENEED BY THE 2008 AD-HOC ENERGY MINISTERS MEETINGS HELD IN JEDDAH AND LONDON 124 (International Energy Forum, Jan. 16, 2010), available at <http://www.michaelgreenberger.com/files/IEF-Greenberger-AppendixVII.pdf>.

⁹⁵ See Patrick Jenkins and Brooke Masters, *UK watchdogs' stance on bank capital attacked*, FIN. TIMES (March 27, 2011); see also Patrick Jenkins and Brooke Masters, *Higher capital ratios talk cuts banks' appeal*, FIN. TIMES (March 27, 2011).