

November 4, 2020

CFTC Adopts Final Rule for Position Limits

The Final Rule Applies Federal Position Limits to Additional Futures Contracts and Economically Equivalent Swaps, Raises Limits on Legacy Agricultural Contracts and Generally Expands Exemptions from Position Limits, Among Other Changes

SUMMARY

On October 15, 2020, the Commodity Futures Trading Commission (the “CFTC” or “Commission”) voted 3-2 (Commissioners Behnam and Berkovitz dissenting) to adopt a final rule regarding limits on the size of positions in futures on enumerated physical commodities (the “Final Rule”).¹ The Final Rule supersedes and replaces the CFTC’s prior Dodd-Frank position limits efforts and is the culmination of a lengthy rulemaking process, including a 2011 final rule, which was vacated by a federal court, a 2013 proposal, a 2016 supplemental proposal and re-proposal and, finally, the January 2020 proposal (the “Proposed Rule”).

The Final Rule has a general compliance date of January 1, 2022, with certain exceptions. The elimination of the risk management exemption and position limits for economically equivalent swaps will become effective on January 1, 2023. Additionally, the expanded bona fide hedging definitions and the higher limit levels for the legacy agricultural futures contracts will become effective 60 days after the Final Rule is published in the Federal Register.²

STRUCTURE OF THE FINAL RULE

Consistent with the Proposed Rule, the Final Rule applies limits to positions in a list of 25 identified physically delivered “core referenced futures contracts” (“CFRCs”), linked futures and options and economically equivalent swaps. Limits will initially be applicable only in the “spot month,” which refers to the delivery period of the contract. There are also several categories of exemptions from the position limits regime, including the following: (1) bona fide hedging transactions and positions; (2) spread and arbitrage

positions; (3) certain financial distress positions; (4) certain natural gas positions held during the spot month; and (5) pre-enactment and transition period swaps—each discussed in more detail below.

Exchanges that list contracts subject to federal position limits must set their own limits for such contracts at a level no higher than the federal level, though exchanges may grant certain exemptions.³ For physical commodity contracts not subject to federal limits, exchanges generally are required to set spot month limits no greater than 25 percent of deliverable supply, but have flexibility to submit other approaches for CFTC review.⁴ Exchanges also generally have more flexibility in setting limits or accountability levels outside of the spot month.⁵ Absent an exemption, market participants must comply with such exchange-set limits. The Final Rule also requires exchanges to establish, consistent with standards set forth in the Final Rule, position limits for the 16 “non-legacy” CRFCs and any associated referenced contracts.⁶

KEY OBSERVATIONS

- **Necessity finding.** In *ISDA v. CFTC*,⁷ a federal district court for the District of Columbia vacated the Commission’s 2011 position limit rule on the basis that, prior to promulgating position limits, the CFTC must first determine whether the CEA required the Commission to make a finding that such limits were necessary. As in the Proposed Rule, the Final Rule addresses the *ISDA* ruling by interpreting the CEA to require the CFTC to make a necessity finding prior to establishing position limits, and the Final Rule includes the CFTC’s necessity finding with respect to the 25 CRFCs.⁸ The Preamble notes that the necessity finding is based on two interrelated factors: (1) the importance of the 25 CRFCs to their underlying cash markets (including that they require physical delivery) and (2) the commodities’ importance to the national economy.⁹ The CFTC’s necessity finding also determined that position limits are necessary during the spot month for all 25 CRFCs and outside of the spot month only for the nine legacy agricultural commodity contracts.¹⁰
- **Scope of contracts; physically settled versus financially settled.** Position limits under the rule will apply to a market participant’s positions in the 25 CRFCs, linked futures and options, and economically equivalent swaps (collectively, “referenced contracts”). The Final Rule requires firms to aggregate their *net* long and *net* short positions across all such categories of instruments. For the limits on the nine legacy agricultural contracts in non-spot months, all positions (both physically and financially settled) must be netted together. In the spot month, position limits apply to each separately (and there is no netting between physical and financial positions).¹¹ In all cases, market participants may only net contracts that are subject to limits (e.g., for swaps, only economically equivalent swaps).
- **Spot month versus non-spot month.** Other than the nine legacy agricultural contracts (where the Final Rule includes any and all month limits), the rest of the Final Rule’s limits only apply in the spot month, which is the period immediately before delivery obligations are incurred for physical-delivery contracts or the period immediately before contracts are liquidated by the clearinghouse based on a reference price for cash-settled contracts.¹²
- **Limit levels.** The limit levels (reproduced in the table at the end of this memorandum) are generally higher than the existing CFTC (for agricultural contracts) and exchange (for energy and metals) set position limits for these contracts. With the exception of the limits for the cotton contract, discussed in more detail below, the position limits in the Final Rule are the same as those in the Proposed Rule.
- **Linked futures and options.** As mentioned above, the Final Rule applies to futures contracts and options on futures that are “directly or indirectly linked to a [CRFC].”¹³ The Preamble notes that such contracts include any contracts that are (i) directly or indirectly linked to the price of a CRFC or (ii) directly or indirectly linked to the price of the same commodity underlying the applicable CRFC, for delivery at the same location as specified in the CRFC. The Final Rule, however, explicitly excludes

certain contracts from the definition of referenced contracts, including: basis contracts, commodity index contracts, contracts that are based on prices across months (e.g., calendar month average contracts, trade month average contracts and balance of month contracts), outright contracts that are based on a price reporting agency index price, swap guarantees and certain trade options.

- **Economically equivalent swaps.** Economically equivalent swaps, which are subject to position limits under the Final Rule, are defined as swaps with “identical material” contractual specifications, terms and conditions to a CRFC, disregarding differences with respect to any of the following three categories: (i) lot size specifications or notional amounts, (ii) post-trade risk management arrangements (e.g., uncleared swaps versus cleared futures contracts), and (iii) delivery dates for physically settled swaps as long as these delivery dates diverge by less than one calendar day from the referenced contract’s delivery date (or, for natural gas, two calendar days).¹⁴ Notably, the Preamble states: “Because the Commission considers settlement type to be a material ‘contractual specification, term, or condition,’ a cash-settled swap could only be deemed to be economically equivalent to a cash-settled referenced contract, and a physically-settled swap could only be deemed to be economically equivalent to a physically-settled referenced contract. However, a cash-settled swap that initially did not qualify as ‘economically equivalent’ due to [the fact that there is] no corresponding cash-settled referenced contract (i.e., no cash-settled look-alike futures contract) could subsequently become an ‘economically equivalent swap’ if a cash-settled futures contract market were to develop.”¹⁵ As noted above, firms must come into compliance by January 1, 2023 with the economically equivalent swaps rules.
- **Bona fide hedging exemptions**
 - **Enumerated bona fide hedging exemptions.** The Final Rule includes an exemption from limits for bona fide hedging transactions or positions and expands the current list of enumerated bona fide hedges to cover additional hedging practices, as well as hedges of anticipated merchandising. If a transaction or position is included in a list of enumerated hedges set forth in Appendix A of Part 150 (reproduced in the table at the end of this memorandum), the exemption would be self-effectuating (i.e., the market participant does not need to apply to the Commission to rely on the exemption) for purposes of federal limits, and a person would only be required to request the bona fide hedge exemption from the relevant exchange for purposes of exchange-set limits.¹⁶ The enumerated categories of hedges listed in Appendix A are explicitly incorporated in the Final Rule, in response to concerns raised with respect to the Proposed Rule that Appendix A lacked formal status.¹⁷
 - **Non-enumerated hedges.** Transactions or positions that do not fit within one of the enumerated hedges could still be recognized as a bona fide hedge, though market participants must apply to both the CFTC and the relevant exchanges for approval before relying on such an exemption.¹⁸ A market participant may exceed position limits during the time in which an application for a non-enumerated hedge exemption is pending CFTC review.¹⁹ While this is done at the market participant’s risk as the Commission could ultimately deny the request, the Final Rule provides that the CFTC will not bring enforcement actions for violations during the review period so long as the application was made in good faith and the market participant takes commercially reasonable efforts to reduce the position (as necessary) following the Commission’s decision.²⁰ Absent Commission action, the application will be deemed approved two or ten days after the application (depending on the circumstances), though the Final Rule provides the Commission the ability to stay the deadline for up to 45 days.²¹ In a related matter, the Commission also voted 3-2 (Chairman Tarbert and Commissioner Quintenz dissenting) to approve an amendment to the Preamble, proposed by Commissioner Berkovitz during the October 15 open meeting, to request that exchanges voluntarily provide the Commission with applications for non-enumerated bona fide hedging exemptions as soon as they are received by the exchange, in order to facilitate the Commission’s review of such applications.²²
 - **Hedging on “gross basis” permitted.** Instead of only being permitted to hedge on a “net basis” except in a narrow set of circumstances, market participants may also hedge positions on a “gross

basis” in certain circumstances, provided that the participant has done so over time in a consistent manner and is not doing so to evade the federal limits.²³

- **Modified temporary substitute test; rejection of traditional risk management exemption.** The Final Rule modifies the “temporary substitute test” to require that a bona fide hedging transaction or position in a physical commodity must *always*, and not just *normally*, be connected to the production, sale, or use of a physical cash-market commodity. Therefore, a market participant would generally no longer be allowed to treat positions entered into for “risk management purposes” (i.e., derivatives positions, typically held by a swap dealer, used to offset a swap position, such as a commodity index swap, with another entity for which that swap is not a bona fide hedge) as a bona fide hedge, unless the position qualifies as either (i) an offset of a “pass-through swap,” where the offset reduces price risk attendant to a pass-through swap executed opposite a counterparty for whom the swap qualifies as a bona fide hedge; or (ii) a “swap offset,” where the offset is used by a counterparty to reduce price risk attendant to a swap that qualifies as a bona fide hedge and that was previously entered into by that counterparty.²⁴ As a result, and because the Final Rule does not provide for an independent risk management exemption, any previously granted CFTC risk management exemptions will phase out on January 1, 2023.
- **Form 204/304 reports.** As mentioned above, under the Final Rule enumerated bona fide hedges are self-effectuating, provided that the market participant separately applies to the relevant exchange for an exemption from exchange limits. As a result, such market participants would no longer be required to file Form 204/304 with the CFTC on a monthly basis to demonstrate cash-market positions justifying position limit overages.²⁵
- **Additional Changes from the Proposed Rule.**
 - **Section 4a(a)(7) of the CEA.** The Preamble acknowledges that section 4a(a)(7) of the CEA, which provides the CFTC with general exemptive authority with respect to position limits, remains an independent avenue through which the Commission may grant exemptions from position limits.²⁶ For example, the Commission stated that it was exercising its authority under section 4a(a)(7) to provide certain exemptions for natural gas position limits, discussed in more detail below.²⁷ The CFTC also noted that, while it will no longer recognize risk management positions as bona fide hedges under the Final Rule, section 4a(a)(7) is another authority that could allow the Commission “to exempt risk management positions from federal position limits.”²⁸
 - **Unfixed price transactions.** Commercial end users that have entered into unfixed price transactions may qualify for an enumerated bona fide hedge exemption. The Final Rule affirms and broadens the position set forth in Staff Letter No. 12-07, which provided that “unfilled anticipated requirements may be recognized as the basis of a bona fide hedging position or transaction under [Rule] 151.5(a)(2)(ii)(C) when a commercial enterprise has entered into long-term, unfixed-price supply or requirements contracts.”²⁹ As a result, commercial market participants with unfixed price transactions may qualify for bona fide hedge treatment under the enumerated bona fide hedge exemptions for anticipatory merchandising, anticipated unsold product, or anticipated unfilled requirements. The Final Rule does not, however, adopt a stand-alone exemption for unfixed price transactions, and the Preamble notes that a “commercial market participant that enters into an unfixed-price transaction may qualify for one of these anticipatory bona fide hedges as long as the commercial entity otherwise satisfies all requirements for such anticipatory bona fide hedge, including demonstrating its anticipated need in the physical marketing channel related to either its unsold production, unfilled requirements, and/or merchandising, as applicable.”³⁰
 - **Spread and arbitrage exemptions.** The Final Rule expands the definitions of spread exemptions to include intra-market spreads, inter-market spreads, intra-commodity spreads, and inter-commodity spreads, including calendar spreads, quality differential spreads, processing spreads, product or by-product differential spreads, and futures-options spreads.³¹ The Final Rule also adds a new Appendix G, which provides additional guidance on the types of spreads that will fit the

definition and core principles that the exchanges should consider when reviewing these exemptions.³² Spread strategies that meet the definition are self-effectuating for purposes of federal limits, although the market participant must separately apply to the applicable exchange for an exemption from exchange-set limits. Market participants with a spread position that does not fit within the “spread transaction” definition may apply directly to the Commission for an exemption.³³

- **Pass-through swap exemption.** The pass-through swap exemption provides an exemption for swaps that “by themselves do not meet the [bona fide hedge exemption] criteria . . . but that are used to offset the swap exposure of a market participant (e.g., a dealer) to the extent that the swap exposure does satisfy [the bona fide hedge requirements] . . . for such market participant’s counterparty (e.g., a commercial end user).”³⁴ The Final Rule does not require, as the Proposed Rule did, that a pass-through counterparty demonstrate that its offsetting position is attendant to a position resulting from a bona fide hedging pass-through swap. Rather, under the Final Rule, the pass-through swap counterparty may receive a written representation that the pass-through swap qualifies as a bona fide hedge. To qualify, the pass-through counterparty must rely on the representation in good faith and cannot do so if the counterparty has information that would cause a reasonable person to question the accuracy of the representation.³⁵ The Preamble notes that this change provides market participants with flexibility to “determine the form and manner of how they will document the written representation by the bona fide hedging counterparty.”³⁶ As an example, the Preamble notes that parties may agree that the pass-through swap counterparty “may rely on a written representation made by the bona fide hedging swap counterparty that an original pass-through swap and any subsequent pass-through swaps entered into by and between the bona fide hedging swap counterparty and the pass-through swap counterparty are bona fide hedges, unless the bona fide hedging swap counterparty provides written notice to the pass-through swap counterparty that a particular swap is not a bona fide hedge.”³⁷
- **Natural gas position limits**
 - **Disaggregated approach for natural gas.** The Final Rule takes a “disaggregated” approach to NYMEX Henry Hub Natural Gas position limits, under which position limits will apply to the cash-settled contracts on a per-exchange basis, rather than an aggregate basis across all exchanges as was proposed under the Proposed Rule.³⁸
 - **Conditional exemption for certain natural gas positions held during the spot month.** The conditional exemption in the Final Rule permits traders to acquire positions of up to 10,000 cash-settled NYMEX Henry Hub (NG) contracts (the federal spot month limit for cash-settled NG is 2,000 cash-settled NG referenced contracts per exchange and another 2,000 cash-settled NG referenced contracts in the OTC swaps market) per exchange that lists the relevant cash-settled NG-referenced contracts, along with an additional position in cash-settled economically equivalent NG OTC swaps that have a notional amount of up to 10,000 equivalent-sized contracts, as long as such person does not also hold positions in the physically settled NG referenced contract.³⁹ Distinct from current exchange practice, penultimate day financially settled natural gas products, including penultimate day options, are in scope for limits.⁴⁰
- **Certain financial distress positions.** The Final Rule includes an exemption to allow a market participant to exceed federal limits if necessary to take on the positions and associated risk of another market participant during a potential default or bankruptcy situation. The financial distress exemption requires an application to the CFTC, which will evaluate such applications on a case-by-case basis, depending on the facts and circumstances involved.⁴¹
- **Pre-enactment and transition period swaps.** “Pre-Enactment Swaps,” which are swaps entered into prior to the Dodd-Frank Act whose terms have not expired, and “Transition Period Swaps,” which are swaps entered into between July 22, 2010 and 60 days after the publication of the Final Rule, generally are not subject to federal limits. Note that pre-enactment swaps cannot be netted with post-effective date swaps for purposes of complying with spot month federal position

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limits.⁴² All other “Pre-Existing Positions” that are acquired in good faith prior to the effective date of the Final Rule are subject to federal limits.⁴³

- ***Cotton position limits.*** The Final Rule revises the ICE Cotton No. 2 (CT) limits as follows: 900 in the spot month (compared to 1,800 in the Proposed Rule and 300 in the current rule) and 11,900 for all months combined and 5,950 for single month (compared to 11,900 for both in the Proposed Rule and 5,000 for both in the current rule).⁴⁴
- ***Dissenting Remarks.*** Commissioner Berkovitz noted that the Final Rule does not mark the end of the position limits rulemaking process and specifically referenced certain structural market issues that became evident on April 20, 2020, when WTI futures prices went negative, as well as the potential for manipulation in the “trading at settlement” (or TAS) markets.

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LIMIT LEVELS (AS SET FORTH IN APPENDIX E TO PART 150)

Agricultural

<i>Contract</i>	<i>Spot Month Limit</i>	<i>Single Month and All-Months-Combined</i>
<i>Legacy agricultural</i>		
CBOT Corn (C)	1,200	57,800
CBOT Oats (O)	600	2,000
CBOT Soybeans (S)	1,200	27,300
CBOT Soybean Meal (SM)	1,500	16,900
CBOT Soybean Oil (SO)	1,100	17,400
CBOT Wheat (W)	1,200	19,300
CBOT KC Hard Red Winter Wheat (KW)	1,200	12,000
MGEX Hard Red Spring Wheat (MWE)	1,200	12,000
ICE Cotton No. 2 (CT)	900	5,900 (single month); 11,900 (all-months-combined)
<i>Other agricultural</i>		
CBOT Rough Rice (RR)	800	N/A
CME Live Cattle	600/300/200 <i>(step down over spot period)</i>	N/A
ICE Cocoa (CC)	4,900	N/A
ICE Coffee C (KC)	1,700	N/A
ICE FCOJ-A (OJ)	2,200	N/A
ICE U.S. Sugar No. 11 (SB)	25,800	N/A
ICE U.S. Sugar No. 16 (SF)	6,400	N/A

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Energy

<i>Contract</i>	<i>Spot Month Limit</i>	<i>Proposed Any/ All Month Limit</i>
NYMEX Henry Hub Natural Gas (NG)	2,000* <i>(see conditional limit, above)</i>	N/A
NYMEX Light Sweet Crude Oil (CL)	6,000/5,000/4,000 <i>(step down over spot period)</i>	N/A
NYMEX New York Harbor ULSD Heating Oil (HO)	2,000	N/A
NYMEX New York Harbor RBOB Gasoline (RB)	2,000	N/A

Metals

<i>Contract</i>	<i>Spot Month Limit</i>	<i>Proposed Any/ All Month Limit</i>
COMEX Copper (HG)	1,000	N/A
COMEX Gold (GC)	6,000	N/A
COMEX Silver (SI)	3,000	N/A
NYMEX Palladium (PA)	50	N/A
NYMEX Platinum (PL)	500	N/A

ENUMERATED LIST OF BONA FIDE HEDGES (AS ENUMERATED IN APPENDIX A TO PART 150)

1	Hedges of inventory and cash commodity fixed-price purchase contracts
2	Hedges of cash commodity fixed-priced sales contracts
3	Hedges of offsetting unfixed-price cash commodity sales and purchases
4	Hedges of unsold anticipated production
5	Hedges of unfilled anticipated requirements
6	Hedges of anticipated merchandising
7	Hedges by agents
8	Hedges of anticipated mineral royalties
9	Hedges of anticipated services
10	Offsets of commodity trade options
11	Cross-commodity hedges

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ENDNOTES

- ¹ Commodity Futures Trading Commission, *Position Limits for Derivatives* (Oct. 15, 2020), available at <https://www.cftc.gov/PressRoom/PressReleases/8287-20>. Chairman Tarbert's opening statement is available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement101520b> Commissioner Quintenz's supporting statement is available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement101520c> Commissioner Stump's statement is available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement101520> Commissioner Berkovitz's dissenting statement is available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatementb101520b> Commissioner Behnam's dissenting statement is available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement101520c>
- ² See Preamble at 32-33.
- ³ See Preamble at 22 ("Exchanges may grant exemptions from their own limits to a level that exceeds the applicable federal limit, provided the exemption is self-effectuating (e.g., an enumerated bona fide hedge or a spread that satisfies the "spread transaction" definition) or provided the exemption is recognized by the Commission for purposes of federal position limits (pursuant to an application submitted either directly to the Commission under § 150.3 or indirectly to the Commission through an exchange under § 150.9, as applicable). Exchanges may grant exemptions that are not recognized by the Final Rule; however, such exemptions must be capped at a level that is not higher than the applicable federal position limit level.")
- ⁴ See Preamble at 22.
- ⁵ See Preamble at 22-23.
- ⁶ Preamble at 14, n.20.
- ⁷ *Int'l Swaps & Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n*, 887 F. Supp. 2d 259 (D.D.C. 2012).
- ⁸ See Preamble at 49 ("The Commission finds that position limits are necessary for the 25 core referenced futures contracts, including certain commodity derivative contracts that are directly or indirectly linked to a core referenced futures contract.")
- ⁹ Preamble at 49.
- ¹⁰ Preamble at 49.
- ¹¹ See Preamble at 19 ("During the spot month, federal position limits apply 'separately' to physically-settled and cash-settled referenced contracts. Accordingly, during the spot month, a market participant is required to aggregate its net physically-settled positions, and separately its net cash-settled positions, across exchanges and the OTC swaps markets, but may not net cash-settled referenced contracts with physically-settled referenced contracts.")
- ¹² See, e.g., Preamble at 600 ("[T]he Commission preliminarily determined that federal position limits should only apply to spot month positions except with respect to the nine legacy agricultural contracts, where non-spot month position federal position limits have been in place for many years. As discussed above, the Commission is adopting this aspect of the rule as proposed. Consistent with this policy determination, the Commission finds that position limits are necessary during all months for the nine legacy agricultural contracts. The Commission further finds that position limits are necessary only during the spot month for the 16 non-legacy core referenced futures contracts and unnecessary outside of the spot month."). Note that the "spot month" is not necessary equal to a single, month-long period, but refers instead to the delivery period of a contract, which is typically a matter of days.

ENDNOTES (CONTINUED)

- 13 Preamble at 13.
- 14 See Preamble at 15.
- 15 Preamble at 201 (emphasis added).
- 16 See Preamble at 96 (“[E]numerated bona fide hedges are self-effectuating for purposes of federal position limits, provided that the market participant separately requests an exemption from the applicable exchange-set limit established pursuant to § 150.5(a).”).
- 17 See Preamble at 25 (“While the enumerated bona fide hedges will remain listed in Appendix A under the Final Rule, Appendix A to part 150 is now explicitly incorporated by reference into Commission regulations and is part of the regulatory text rather than acceptable practices.”).
- 18 See Preamble at 98, 489-91.
- 19 See Preamble at 30 (“Under the Final Rule, once the exchange notifies the Commission and the applicant of the exchange’s determination to approve the application, the applicant may, at its own risk, exceed federal position limits during the Commission’s 10 business-day review period. . . . If the Commission determines to deny an exemption application, the applicant will not be subject to any federal position limits violation, provided the person filed the application in good faith and brings the position into compliance with the applicable federal position limit within a commercially reasonable amount of time, as applicable.”).
- 20 Preamble at 31.
- 21 See Preamble at 30, 525.
- 22 See Preamble at 522 (“[T]he Commission would consider it to be a reasonable and helpful practice if exchanges elect to provide information to the Commission on non-enumerated bona fide hedge applications as the exchange is considering such applications. That is, the Commission would find it helpful to receive an advance courtesy copy of any § 150.9 applications the exchange receives. The exchange is not, however, required to provide such advance copies, and would not be required to obtain an opinion on such applications from the Commission before making its determination. Rather, providing such application information as the exchange receives it could facilitate a more rapid Commission evaluation of § 150.9 applications. This would help facilitate additional regulatory certainty for market participants and would aid the Commission in its review of applications processed under § 150.9.”).
- 23 See Preamble at 26 (“Instead of only being permitted to hedge on a ‘net basis’ except in a narrow set of circumstances, a market participant is also able to generally hedge positions on a ‘gross basis,’ provided that the participant has done so over time in a consistent manner and is not doing so to evade federal position limits.”).
- 24 See Preamble at 27-28.
- 25 See Preamble at 29.
- 26 See Preamble at 69 (“[T]he Commission maintains other authorities, including the authority under CEA section 4a(a)(7), to exempt risk management positions from federal position limits.”).
- 27 See Preamble at 239, n.487.
- 28 Preamble at 69.
- 29 CFTC Letter No. 12-07 (Aug. 16, 2012), available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/12-07.pdf> The interpretation set forth in Letter No. 12-07 was, however, relatively narrow. As the preamble notes: “the price risk of such ‘unfilled’ anticipated requirements is not offset by the unfixed-price forward contract because the price risk remains with the commercial entity, even though the entity has contractually assured a supply of the commodity. Instead, the price risk continues until the unfixed-price contract’s price is fixed. Once the price is fixed on the supply

ENDNOTES (CONTINUED)

- contract, the commercial entity no longer has price risk, and its derivative position, to the extent the position is above an applicable position limit, and unless the market participant qualifies for another exemption, must be liquidated in an orderly manner in accordance with sound commercial practices.” Preamble at 81-82.
- 30 Preamble at 88.
- 31 See Preamble at 273-74 (“[T]he Commission is expanding the proposed ‘spread transaction’ definition to make clear that the definition as finalized includes intra-market, inter-market, and intra-commodity spread positions. . . . The final ‘spread transaction’ definition will cover: intra-market spreads, inter-market spreads, intra-commodity spreads, and inter-commodity spreads, including calendar spreads, quality differential spreads, processing spreads, product or by-product differential spreads, and futures-options spreads. The Commission intends for the spread definition to be sufficiently broad to capture most, if not all, spread strategies currently granted by exchanges and used by market participants.”).
- 32 See Final Rule Appendix G at 893.
- 33 See Preamble at 421-25.
- 34 Preamble at 176-77.
- 35 See Preamble at 180-81.
- 36 Preamble at 185, n.379.
- 37 Preamble at 185.
- 38 Preamble at 19.
- 39 See Preamble at 336, 338.
- 40 See Preamble at 344.
- 41 See Preamble at 28, 425-26. The Preamble notes: “For example, in periods of financial distress, such as a customer default at an FCM or a potential bankruptcy of a market participant, it may be beneficial for a financially-sound market participant to take on the positions and corresponding risk of a less stable market participant, and in doing so, exceed federal speculative position limits. Pursuant to authority delegated under §§ 140.97 and 140.99, Commission staff previously granted exemptions in these types of situations to avoid sudden liquidations required to comply with a position limit. Such sudden liquidations could otherwise potentially hinder statutory objectives, including by reducing liquidity, disrupting price discovery, and/or increasing systemic risk.” Preamble at 425.
- 42 Preamble at 230.
- 43 See, e.g., Preamble at 385.
- 44 See Preamble at 17, 21.

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