UNIVERSITY OF MARYLAND
SCHOOL OF LAW

November 26, 2010

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Notice of Proposed Rulemaking on Agricultural Commodity Definition.

Dear Mr. Stawick:

These comments are submitted in response to the questions in the Notice of Proposed Rulemaking[1] issued by the Commodity Futures Trading Commission ("CFTC" or "Commission") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act[2] (the "Dodd-Frank Act"). At the outset, it should be said that the potential benefits of defining the term "agricultural commodity" clearly are enormous. As such, it is critical that the Commission follow the tenets of the Dodd-Frank Act and promulgate rules and regulations that will reduce price volatility and increase transparency in agricultural markets.

I. General Comment

In response to the 2007/2008 food crisis, 184 U.S.- based and international human rights and hunger relief organizations sent a letter to President Obama advocating for the "re-regula[ion of] the food and energy commodities futures markets to remove excessive speculation that has so clearly increased price volatility in the last few years."[3] The letter noted that "[b]etween May

---

[1] Proposed Rules, 75 Fed. Reg. 65586 (October 26, 2010).

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

[3] Letter to President Obama from domestic and international human rights and hunger relief organizations March 24, 2009, *available at* http://www.foodfirst.org/files/pdf/Food%20Speculation%20Coalition%20Letter%20to%20President%20Obama%20.pdf (last visited on November 18, 2010).

500 West Baltimore Street • Baltimore, Maryland 21201-1786 410-706-7412 • www.law.umaryland.edu

2007 and March 2008, hard red winter wheat rose 137 percent, from July 2007 to June 2008 corn prices rose 98 percent. Other food commodities rose in a similar fashion putting daily sustenance out of reach for 200 million more people in the developing world. Families used to buying kilos of food were only able to buy cups of the same food items. People went hungry. Children stopped growing for months at a time, others perished."[4] Moreover, one leading agricultural economist, Joachim von Braun, recently stated that "For [the world's poorest three billion people], the price of wheat or rice plays a huge role in their lives -- and survival. What we refer to as hunger, or a lack of sufficient calories, is only part of the deeper problem of silent hunger, which is triggered by malnutrition. This affects about two billion people. And the consequences are irreversible."[5]

This devastating food crisis has accelerated once again. Recently, a Food and Agriculture Organization economist, Abdolreza Abbassian, 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)."[6] He further added that, although wheat and rice are so far fairly balanced, increasing food price volatility would be *alarming* and could potentially *threaten future food security*.[7]

Contrary to the real world impact of rising prices across the world, some major financial services market participants now argue that agricultural markets currently function well.[8] This argument both shockingly cold hearted and also is seriously flawed. In fact, in the U.S., prices of agricultural commodities have increased unjustifiably and, therefore, have further damaged the already struggling economy. At the time of this writing, it is estimated that almost 20 percent of Americans are planning to prepare less food for this year's Thanksgiving because of the higher prices in supermarket staples.[9] Furthermore, it is reported that "Gap Inc., J.C. Penney Co. and other U.S. retailers may have to pay Chinese suppliers as much as 30 percent more for clothes as

---

[4] *Id*.

[5] *See* Interview of Professor Joachim von Braun, *The Dangers of Agricultural Speculation: 'Price Increases Are Costing Millions of People their Health*,' SPIEGEL ONLINE MAGAZINE (Aug. 25, 2010), *available at* http://www.spiegel.de/international/business/0,1518,713456,00.html.

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

[7] *Id*. (emphasis added).

[8] *See* Comment Letter from Gavilon Group, LLC to David A. Stawick, Secretary, CFTC, October 28, 2010, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26338&SearchText=; *See also* Comment Letter from Agricultural Commodity Swaps Working Group to David A. Stawick, Secretary, CFTC, October 29, 2010, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26352&SearchText=.

[9] *See* Lisa Baertlein, *Higher prices for supermarket staples like meat, vegetables, butter, eggs, milk and bread threaten to take a bite out of this year's Thanksgiving dinner plans, a survey showed on Thursday*, REUTERS (Nov. 18, 2010), *available at* http://www.reuters.com/article/idUSTRE6AH48420101118.

surging cotton prices boost costs."[10] What this means for the American consumer is that these retailers will be forced to shift the higher prices to their consumers.[11] Indeed, one market observer recently said, "American consumers better get used to rising prices on the shelves of Wal-Mart and other retailers."[12] If this is the impact of price volatility on the world's largest and strongest economy, the impact on third world countries will be exponentially more devastating.

U.S. food staples prices are now rising faster than overall inflation. According to the U.S. Bureau of Labor Statistics, "the consumer price index for all items minus food and energy rose 0.8% over the year to September, the lowest 12-month increase since March 1961. […] The food index rose 1.4%, however."[13] As explained below, *speculative trading in multiple commodities indices* is incontrovertibly a main driving force of rising commodity prices and price volatility. While all other prices remain flat, such speculation wreaks havoc on the American consumer as well as consumers worldwide in the form of rising food and energy prices.[14]

II. Index Speculation & Market Fundamentals

In light of the 2007/2008 food crisis, Congress held numerous hearings to examine the role of index speculation trading and its impact on the price of commodities. During these

---

[10] Michael Wei, *Gap, Wal-Mart Clothing Costs Rise on `Terrifying' Cotton Prices*, BLOOMBERG (Nov. 15, 2010), *available at* http://www.bloomberg.com/news/2010-11-16/gap-wal-mart-clothing-suppliers-raise-prices-on-terrifying-cotton-costs.html.

[11] Food makers and retailers including, *inter alia*, McDonald's Corp., Kellogg Co. Kroger Co., Kraft Foods Inc., Sara Lee Corp., General Mills Inc., and Starbucks Corp., announced that they are planning to raise prices on certain items because of the rise in commodity prices. *See* Julie Jargon and Ilan Brat, *Food Sellers Grit Teeth, Raise Prices Packagers and Supermarkets Pressured to Pass Along Rising Costs, Even as Consumers Pinch Pennies*, WALL ST. J. (Nov. 4, 2010), *available at* http://online.wsj.com/article/SB10001424052748704506404575592313664715360.html.

[12] Michael Wei, *Gap, Wal-Mart Clothing Costs Rise on `Terrifying' Cotton Prices*, BLOOMBERG (Nov. 15, 2010), *available at* http://www.bloomberg.com/news/2010-11-16/gap-wal-mart-clothing-suppliers-raise-prices-on-terrifying-cotton-costs.html (quoting Jessica Lo, Shanghai-based managing director at China Market Research Group).

[13] *See* Julie Jargon and Ilan Brat, *Food Sellers Grit Teeth, Raise Prices Packagers and Supermarkets Pressured to Pass Along Rising Costs, Even as Consumers Pinch Pennies*, WALL ST. J. (Nov. 4, 2010), *available at* http://online.wsj.com/article/SB10001424052748704506404575592313664715360.html.

[14] *Id*.

hearings, some of the leading experts demonstrated that index speculation was a major causative factor in the "bubble-like price rises in those commodities."[15]

Index speculation has not slowed down. "Financial investors have pumped $17bn (pounds 10.8bn) into global commodity funds so far this year, pushing precious metals and agricultural staples such as maize and other grain to record heights."[16] This influx of capital into the commodity markets "fuel[ed] rising food and fuel prices across the world and risking the kind of unrest seen across the world two years ago."[17]

The last of a series of three bipartisan staff reports of the Senate Permanent Subcommittee on Investigations is critical evidence that commodity indices place a huge speculative premium on food staples for consumers. On June 24, 2009 that report demonstrated conclusively that 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"[18] and "commodity index instruments were, in essence, *speculative bets*."[19] The 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."[20]

Notably, China, where the world's four biggest agricultural contracts are traded, recently announced that it "will raise costs to buy and sell farm-product and metals futures as part of a

---

[15] *See* Written Testimony of Professor Michael Greenberger, *Ending Excessive Speculation in Commodity Markets: Legislative Options*, Hearing Before the PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE COMMITTEE ON HOMELAND AND SECURITY AND GOVERNMENTAL AFFAIRS (June 24, 2009), *available at* http://www.michaelgreenberger.com/files/June_24_2008_testimony.pdf. *See also* Written Testimony of Michael Masters, *Ending Excessive Speculation in Commodity Markets: Legislative Options*, Hearing Before the PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE COMMITTEE ON HOMELAND AND SECURITY AND GOVERNMENTAL AFFAIRS (June 24, 2009), *available at* http://hsgac.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=b5b714c5-0b2e-4ab1-b1dc-2317a7d22e47 (last visited on November 24, 2010) [hereinafter "Masters Testimony"].

[16] Elena Moya, *Field of Dreams: Hedge Funds Put Faith in Grain*, SOYATECH (Oct. 20, 2010), *available at* http://www.soyatech.com/news_story.php?id=20588 (last visited on November 19, 2010).

[17] *Id*.

[18] PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE COMMITTEE ON HOMELAND AND SECURITY AND GOVERNMENTAL AFFAIRS, EXCESSIVE SPECULATION IN THE WHEAT MARKET (June 24, 2009) at 120.

[19] *Id.* at 94 (emphasis added).

[20] *Id*. at 2-3.

government *effort to limit speculation* and tame inflation."[21] It is reported that "CME Group Inc. and other U.S. and European commodity exchanges also are charging more to trade some raw materials after prices jumped."[22] According to a key market participant, "raising fees to be active on the exchange is a predictable move to *try to calm down speculative investment*."[23] The message is clear. Even commodity participants are acknowledging the unreasonable rise in the prices of commodities by index speculators and are trying to stabilize the commodity prices by imposing high transactional fees.

III. Legislative Intent to Provide Additional Protections for Agricultural Commodities

One of the main principals shaping derivatives regulation under the Dodd-Frank Act is to provide free and open access to *clearing and exchange trading* by financial institutions.[24] Simply put, clearing and exchange trading are designed to reduce risk by providing price transparency, requiring that investors set aside adequate capital in case of default, and producing public information on who is involved in trading and to what extent.[25] To achieve this goal, the Act broadly defines "swaps," so that "swaps" will be subject to clearing and exchange trading requirements as well as subject to position limits.

Indeed, this broad definition of "swaps" includes commodity index funds,[26] which do not exchange a series of cash flow, but require a fixed price for underlying basket of commodities.[27]

---

[21] William Bi and Tony C. Dreibus, China Commodity Bourses Raise Trading Fees to Cut Speculation, Price Gains, Bloomberg (Nov. 24, 2010), *available at* http://www.bloomberg.com/news/2010-11-24/china-commodity-bourses-raise-trading-fees-to-cut-speculation-price-gains.html (emphasis added).

[22] *Id.*

[23] *Id*. (emphasis added).

[24] *See*, e.g., S. REP. 111-176, at 32–35 (2010) (noting that draft provisions concerning OTC derivatives were designed to minimize non-cleared, off-exchange trades) (emphasis added); *Public Roundtable on Governance and Conflicts of Interest in the Clearing and Listing of Swaps: Commodity Futures Trading Commission and Securities and Exchange Commission*, at 33 (Aug. 20, 2010) (statement of Randy Kroszner, University of Chicago, Booth School of Business) ("And the law is clear: Open access is the fundamental principle.").

[25] S. REP. 111-176, *supra* note 24, at 29–35 ("The combination of these new regulatory tools will provide market participants and investors with more confidence during times of crisis, taxpayers with protection against the need to pay for mistakes made by companies, derivatives users with more price transparency and liquidity, and regulators with more information about the risks in the system.").

[26] E.g., Standard & Poors - Goldman Sachs Commodity Index, UBS Bloomberg Constant Maturity Commodity Index, and Dow Jones – AIG Commodity Index.

[27] The term, "swap" means any agreement, contract, or transaction that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on […] commodities, […], indices; or transaction commonly known as a commodity swap. *See* §721(a)(21)(47).

Therefore, these commodities index funds should already be subject to clearing and exchange trading requirements. In other words, any commodity index fund that is, in fact, not subject to clearing and trading requirements is in contravention of the Dodd-Frank Act. Then, the question is, taking the legislative intent into consideration, should there be additional protections for commodities indices that reference the prices of agricultural commodities?

The short answer is yes. The Commission must follow the legislative intent and exercise its authority by acknowledging the severe day-to-day challenges with which the average American is confronting. Also, the Commission must take the critical first steps needed to protect U.S. commodity markets from excessive speculation. As stated below, the Dodd-Frank Act has specific provisions built into the law to provide additional protections for agricultural commodities.

Section 723(c)(3)(B) of the Dodd-Frank Act states that "no person shall offer to enter into, enter into, or confirm the execution of, any swap in an *agricultural commodity*."[28] Also, Section 733, which adds a new § 5h to the CEA, provides that a swap execution facility "may not list for trading or confirm the execution of any swap in an *agricultural commodity* except pursuant to a rule or regulation of the Commission allowing the swap under such terms and conditions as the Commission shall prescribe."[29] Furthermore, Section 737 amends CEA § 4a to direct the Commission to adopt position limits for futures, exchange-traded options, and swaps that are economically equivalent to futures and exchange-traded options … within 270 days of the date of enactment of the Dodd-Frank Act for *agricultural commodities*.[30]

Why did Congress add these specifically tailored provisions for agricultural commodities to the Dodd-Frank Act? The answer is simple. Congress was well aware of the importance of price stability the agricultural markets and found it imperative to impose a critical duty on the Commission to provide necessary protections for the agricultural market fundamentals through its rulemaking power. Notably, even before Dodd-Frank, Congress treated agricultural markets in a highly protective fashion. The Commodity Futures Modernization Act of 2000, which otherwise completely deregulated swaps markets and other derivatives products from under the then-existing CEA and almost all other federal and state law, refused to exempt agricultural commodities from the CFMA deregulatory regime.[31] Congress's special treatment of agricultural commodities in Dodd-Frank is emblematic of Congress' strong interest in protecting farmers and agricultural consumers from price volatility caused by excessive speculation.

Commission staff have emphasized that the legislative intent of the Dodd-Frank Act is to provide additional protection from excessive speculation in the agricultural markets. During the

---

[28] *See* § 723(c)(3)(B) (emphasis added).

[29] *See* § 733 (emphasis added).

[30] *See* § 737 (emphasis added).

[31] "The § 2(g) exemption explicitly excluded any agreement, contract, or transaction" in an "agricultural commodity." *See* § 105(b) of the Commodity Futures Modernization Act, 7 U.S.C. 1(a).

CFTC Agricultural Swaps Rulemaking Team's presentation, Don Heitman stated: "By requiring a §4(c) exemption, granted by the CFTC, as a precondition to allowing agricultural swaps to trade, *Congress seems to imply that farmers and other persons trading agricultural swaps should be subject to some kind of additional, special protections beyond those available to persons trading swaps in other physical commodities*."[32] Mr. Heitman is absolutely correct.

IV. Cost Benefit Analysis

As stated in the Proposed Rules, Section 15(a) of the CEA requires the Commission to consider the costs and benefits of the subject regulations in light of five broad areas of market and public concern.[33] It provides that the Commission may, in its discretion, give greater weight to any one of the five enumerated areas of concern and may, in its discretion, determine that, not withstanding its costs, a particular regulation is necessary or appropriate to *protect the public interest*.[34]

Here, the Commission must keep in mind that it is in the public interest for the average Americans (and for the consumers across the world (especially the Third World) whose food prices are directly or indirectly affected by American farm prices) to pay a reasonable market price for bread, milk, and other necessary food staples. Non-commercial speculators who are using farm commodities solely for non-commercial bets on the price of food products do not have the best interest of the public at heart. Those who invest in commodities in this fashion do so in anticipation that the prices of commodities will rise in the "long only" commodity index environment.[35] Given the current state of the commodities markets, there is no doubt that index speculators are contributing to the uncontrollable price volatilities and ever-increasing prices. In fact, one market participant recently stated that "We are on the verge of another commodity bull run […] Wealthy clients are looking to buy commodity futures, physical commodities, exchange-

---

[32] Presentation by Don Heitman, Agricultural Swaps Rulemaking Team, Commodity Futures Trading Commission, *Agriculture and the Dodd-Frank Bill* (August 5, 2010) at 10, *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/speechandtestimony/aac080510_heitman.pdf (Note that there was a Disclaimer: "The opinions expressed in this presentation do not represent the official views of the Commission, its staff, or even, necessarily, myself.").

[33] (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of the market for listed derivatives; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. *See* 7 U.S.C. 19(a)

[34] *See* 7 U.S.C. 5

[35] *See* Written Testimony of Michael Masters, BEFORE THE FINANCIAL CRISIS INQUIRY COMMISSION, June 30, 2010, *available at* http://fcic.gov/hearings/pdfs/2010-0630-Masters.pdf (last visited on November 24, 2010) (stating "Those who 'invest' in commodities do so only in the belief that those commodities will rise in price as they become more scarce. Commodities 'investment' is therefore, in effect, a form of hoarding. Commodities are essential to our economy (like energy) or essential to life itself (like food). Modern society cannot survive without the ability to consume commodities.").

traded funds and equities with commodity exposure."[36] Notably, he also stated: "Some investors, however, are troubled about the prospect of contributing to another food price spike as seen in 2007/08 or about the sustainability of using food stocks as biofuels, raising questions about the ethics of agriculture investing."[37] In light of this, taking into consideration the current rising prices in food staples and, in the light of the 2007/2008 food crisis, the Commission must provide additional protections for agricultural commodities beyond those which are merely necessary to ensure that the commodity indices are not in contravention of the Dodd-Frank Act. Therefore, it is only by providing such addition protections that the Commission can rest assured that it is acting with the interests of the American people at heart.

The Commission is correct that the definition of agricultural commodity will be necessary for later substantive rulemakings, such as setting speculative position limits for agricultural commodities under section 737 of the Dodd-Frank Act. And, it has broadly recognized and recognized by Congress in particular in passing section 737, that speculative position limit is the most effective tool to curb the excessive speculation that unmoors food prices from market fundamentals.[38]

V. Definition of Agricultural Commodity Should Include a Contract Based on an Index of the Prices of Any Agricultural Commodities

The Proposed Rules propose to add the following definition: "Commodity-based contracts based wholly or principally on a single underlying agricultural commodity."[39] However this definition fails to include a contract based on an index of the prices of multiple agricultural commodities,[40] i.e., the Standard & Poors - Goldman Sachs Commodity Index, UBS Bloomberg Constant Maturity Commodity Index, and the Dow Jones – AIG Commodity Index. (hereinafter "Multiple Commodities Index"). The Proposed Rules, then states that "a swap contract based on a price index of equal parts wheat, corn and soybeans, or even a swap based on a price index of 50% corn and 50% wheat, would not be based wholly or principally on a single underlying

[36] Laura MacInnis, *Investors primed for higher farm commodity prices*, REUTERS (Nov. 17, 2010), *available at* http://www.reuters.com/article/idUSLDE6AG0U320101117.

[37] *Id*.

[38] "Specifically, we must urgently move to regulate the over-the-counter derivatives market and address excessive speculation through aggregated position limits." Testimony of Gary Gensler, Chairman of the CFTC, before the United States Senate Subcommittee on Financial Services and General Government Committee on Appropriations, June 2, 2009, *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/ChairmanGaryGensler/opagensler-2.html.

[39] *See* Proposed Rules, *note* supra 1.

[40] "[C]ontract based on an index of the prices of multiple agricultural commodities would not be based wholly or principally on a single agricultural commodity and would not fall within the commodity-based contract category." Proposed Rules, *note* supra 1.

agricultural commodity and so would not fall within the agricultural commodity definition."[41] Notably, the Proposed Rules fails to provide any rationale or justification to exclude Multiple Commodities Index from the definition of "agricultural commodity."

The Multiple Commodities Index first became popular in the early part of this decade when institutional investors who suffered as a result of the severe equity bear market began to look for other investment vehicles that have negative correlation to the equity market.[42] Those investors began to pour capital into the commodity markets and speculate that the Multiple Commodities Index would go up, as a result the prices of underlying commodities increased to unhealthy and unreasonable level. Because commodities futures prices are the benchmark for the prices of actual physical commodities, spot prices of these commodities are affected by the Multiple Commodities Index. And these Multiple Commodities Indices are driving up the prices of agricultural commodities to an unhealthy and unreasonable level that completely undermines the public interest.

None of the major Multiple Commodities Indices are "based wholly or principally on a single underlying commodity index." This definition therefore exempts from regulation those major investment tools even though they are loaded with references to various agricultural commodity prices. Indeed, the June 24, 2009, "Red Wheat" report of the Senate Permanent Subcommittee on Investigation conclusively demonstrated that Multiple Commodities Indices have a direct and dangerous impact on the price of Red Wheat when "Red Wheat" is only one of the 25 commodities reference in the relevant Multiple Commodity Index. Therefore, the Commission should reject its proposed definition and include in its agricultural commodity definition each of those multiple commodities indices that reference any farm product into the definition of an "agricultural commodity." In other words, the definition of "agricultural commodity" should include "a swap contract based on a price index of *one or more agricultural commodities*." Doing so would be consistent with the legislative intent, serve the public interest, and bring those Multiple Commodities Indices based on agricultural commodities under the additional protections by imposing necessary and reasonable position limits along with other agricultural commodities.

VI. Conclusion

Agricultural commodities are necessary and critically important elements to the lives of U.S. citizens as well as worldwide consumers of U.S. agricultural products. Therefore, it is critical that agricultural markets adhere to market fundamentals and be transparent. It is now well accepted (especially by Congress) that index speculators are driving up the prices of these agricultural commodities in a manner that does not adhere to market fundamentals and are thereby causing unnecessary volatility in commodity prices. The Commission should include a contract based on an index that includes agricultural commodities within the definition of agricultural commodity, so that it may be subject, *inter alia*, to the later rulemakings on speculative position limits under § 737 of the Dodd-Frank Act. Many lives hang in the balance

[41] *See* Proposed Rules, *note* supra 1.

[42] *See* Masters Testimony at 2, *note* supra 15.

as the Commission debates the exercise of its discretion to combat excessive speculation. The Commission must follow the legislative intent of Congress to protect those agricultural commodities from excessive speculation and, in so doing, to protect the lives of children and families worldwide.

Sincerely,

Michael Greenberger, J.D.
Law School Professor
University of Maryland School of Law