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June 16, 2009

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

COMMENT

Re: 17 CFR Part 150
Whether to Eliminate the Bona Fide Hedge Exemption For Certain Swap Dealers and Create a New Limited Risk Management Exemption from Speculative Position Limits

Dear Mr. Stawick:

Allenberg Cotton Co. is a division of Louis Dreyfus Commodities. It is the largest merchandiser of physical baled lint cotton in the world. Its uses the futures market to hedge its purchases and sales of cotton.

We welcome the opportunity to comment on the appropriate regulatory treatment of swap dealers with respect to existing bona fide hedge exemptions and the concept for a potential conditional risk management exemption.

The Commission has requested comments on fifteen specific questions in its concept release. The American Cotton Shippers Association has submitted a comment with its response on each question that was asked. We endorse ACSA's responses on each and every question.

In response to the Commission's invitation we would like to supply herein our general view in this matter, and elaborate on how it applies to certain questions the Commission asked.

We believe that the only type of risk that should qualify for an exemption from position limits in commodity futures markets is the risk associated with ownership of the underlying physical commodity. This is the vital concept at the core of the Commission's existing enforcement policy on contract manipulation. Allowing other types of risk to qualify for exemptions creates a dichotomy where the physical commodity becomes divorced from ownership of futures and the Commission therefore cannot identify manipulative practices and perform its enforcement responsibilities.

Position limits exist to control the ability of speculative interests to unduly influence futures price movements. The only way that it is possible to isolate and identify manipulative practices is through observation of ownership of futures in relationship to ownership of underlying physicals. It therefore follows that the only entity that can possibly be entitled to a hedge exemption is someone with a commercial interest in the physical commodity.

Last year large flows of money into and out of the cotton futures market resulted in enormous swings in basis levels such that ownership of futures did not provide a viable hedge on physical cotton. This situation fell squarely within the meaning of excessive speculation "causing sudden or unreasonable fluctuations or unwarranted changes" in the price of the commodity under the Commodity Exchange Act. In March of 2008 the options equivalent futures price for cotton reached in excess of a dollar per pound notwithstanding the existence of a carryout in excess of 10 million bales, the highest stock level since the 1960's.

Open interest ballooned as the price peak was reached, and then collapsed as futures fell back to physical levels. Some firms were unable to maintain their hedges due to extremely large margin demands. This was highly detrimental to cotton firms, some of which are no longer in business as a result. Even today some firms prefer to remain unhedged rather than risk exposure to such a situation again.

The Act says that the Commission **shall** fix position limits to "diminish, eliminate, or prevent" such a burden on interstate commerce. The existing hedge exemption for certain swap dealers was a major contributing factor to the sudden fluctuation and unwarranted changes that occurred in the price of cotton last year.

Allowing the hedge exemption for swaps dealers in effect created a giant loophole whereby their counter-parties were able to circumvent the limits that apply to speculative positions.

The result was that by March 4, 2008, the open interest in cotton options and futures combined reached 546,650 contracts. According to the Commitments of Traders report non-commercial and index traders held net long positions on that day of 189,387 contracts. The entire US cotton crop in the 2007/08 season was equal to only 187,120 contracts. The accumulated position of these entities with no commercial interest in

physical cotton was so large that it was able to cause a divorce in the traditional cash/futures relationship in cotton.

The Commission's Question 1 asks, "Should swap dealers no longer be allowed to qualify for exemption under the existing bona fide hedge definition?"

In response, it is clear from this experience that swap dealers should no longer be qualified for exemption under the existing bona fide hedge definition.

The Commission's Question 2 asks, "If so, should the Commission create a limited risk-management exemption for swap dealers based upon the nature of their clients (e.g., being allowed an exemption to the extent a client is a traditional commercial hedger)?"

In response, any limited risk management exemption for a swap dealer should **only** be allowed to the extent that the client is a traditional commercial hedger, and it should be subjected to reporting requirements identifying the activity of the client so that the Commission can ascertain whether speculative limits are being exceeded.

The Commission's Question 8 contemplates the establishment of an exemption for risk taken on against index fund clients. Allowing index funds to qualify as hedgers contributed greatly to the divorce between cash and futures that occurred in cotton last year. On Mar 4, 2008, index funds held net long positions in options and futures combined of 111,288 contracts. This amount exceeded the entire US cotton carryout that year. The ownership had nothing to do with physical cotton.

Entities with no commercial interest in physical cotton have been allowed to distinguish themselves as hedgers as they claim to use commodity futures to mitigate inflation risk. There are other markets such as TIPS that are bona fide venues to offset inflation risk. Allowing the commodity futures markets to be used for this purpose creates the potential for the futures market to become disconnected from the underlying cash commodity market.

Any attempt to use the rationale that a hedge exemption is needed to manage inflation risk should be flatly rejected. Hedge exemptions should not be provided simply due to the fact that a person or entity wants financial exposure to commodities. That is just speculation presented in a masked form.

To allow an entity to qualify for a hedge exemption on the basis of inflation risk or financial risk creates a situation whereby the Commission's anti-manipulation policies become unenforceable. The Commission does not consider financial risks when it considers enforcement proceedings against those actually engaged in the physical trade of cotton. Why should it consider such risks for other entities which have nothing whatsoever to do with cotton?

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As a commercial firm in cotton we have all kinds of financial risks associated with cotton that the Commission does not consider valid when it contemplates position limits or whether manipulation has occurred. The Commission looks only to our physical bales of inventory and purchase and sale commitments when considering whether we have stepped outside of our hedge exemption and entered into a speculative trade. It does not look, for example, to our millions of square feet of cotton warehouse space that we would like to keep filled. We have considerable financial risk associated with this and other cotton infrastructure we own. The Commission's policy is that it does not apply in determining hedge exemptions.

This policy has served the Commission very well over many years. When risks not associated with the physical commodity came to qualify entities other than commercial hedgers for exemption from position limits the result was unbridled speculation.

Entities which do not have a commercial interest in physical commodities are by definition speculators in futures on those commodities, and speculative position limits should apply to those entities.

Many investors want to hold commodities as part their portfolio. This is fine as long as everyone who does not have a commercial interest in the underlying physical commodity abides by speculative position limits on any futures market positions.

Sincerely,

Thomas F. Malone
Chief Operating Officer
Allenberg Cotton Co.
Louis Dreyfus Commodities