Presentation of
Woods Eastland
President, Staple Cotton Cooperative Association
To
Agricultural Advisory Committee
Commodity Futures Trading Commission
Washington, D.C.

August 5, 2010

Chairman Dunn, members of the Commission, and members of the Agricultural Advisory Committee. I am Woods Eastland, President of Staple Cotton Cooperative Association (Staplcotn), headquartered in Greenwood, Mississippi. Staplcotn markets only cotton produced by its members in the Mid-South states of Arkansas, Louisiana, Mississippi, Missouri, and Tennessee, and the Southeastern states of Alabama, Florida, Georgia, North Carolina, South Carolina, and Virginia. Staplcotn annually markets a volume of bales equal approximately to 15% of total U.S. production. As a producer owned cooperative, Staplcotn's aggregated futures and cash positions are always net short futures and net long the basis, the same as the aggregated futures and cash positions collectively of all the cotton producers in the United States.

I recently served as Chairman of the subcommittee of the Cotton Committee of ICE Futures, USA, that was charged with reviewing the Informa study and determining whether recommendations should be made to the cotton committee, and through the cotton committee to the Board of Ice Futures, to change the current delivery points for delivery against the cotton #2 contract.

The recommendations of the subcommittee which were unanimously adopted and forwarded to the Cotton Committee, and subsequently adopted by the Cotton Committee and forwarded to the Board of Ice Futures are:

(1) the addition of Dallas/Fort Worth as a delivery point, and
(2) The deletion of New Orleans as a delivery point on the contract. Such changes are to be effective against the December, 2013, contract.

In reaching this recommendation, it was the sense of the Subcommittee that the following points should be noted:

(1) The Informa report appears to contain certain data which the Subcommittee believes may be inaccurate but that such perceived inaccuracies do not affect the outcome of the Subcommittee's deliberations.
(2) The current terms of the Cotton No. 2 contract are already sufficient to ensure convergence at expiration.
(3) The price volatility seen in March, 2008, was not related to or in any way caused by an insufficient number of or inappropriate distribution of delivery points, and would not have been alleviated by additional or different delivery points at that time.
(4) The addition of Dallas/Fort Worth as a delivery point at this time is appropriate based upon the significance of the location as a commercial cotton concentration point with availability of ample truck and rail infrastructure in and out.

(5) The Subcommittee reviewed the submissions made on behalf of the Port of Corpus Christi, and considered additional potential delivery points on the contract, including Lubbock and West Coast locations, and determined not to recommend any new location other than Dallas/Fort Worth.

(6) Going forward, changes to delivery locations should not be made frequently as the commercial market benefits from consistency and continuity of terms over time.

It is important to state that other than the recommendation and six points enumerated above, the committee did not adopt any other criteria or guidelines for future action by a subsequent committee on this question, and did not detail as a Subcommittee report a set of reasons for recommending the addition of Dallast/Ft. Worth, for recommending the deletion of New Orleans, and for not recommending the addition of any other new delivery points. In my opinion the reason for this is that all agreed on the recommendation and the six points even though each did not have the same reason for reaching those conclusions. I want to make clear, however, that the Subcommittee held very frank and open discussions, did review and discuss the Informa report, written submissions from the Subcommittee members, submissions from the American Cotton Producers, (the national producers segment of the National Cotton Council), and submissions from advocates for Corpus Christi. I believe that all of the presentations mentioned above are posted on the Ice Futures Website.

The views that follow are mine alone as one member of the Subcommittee and the Committee. I do not purport that they represent the views of the majority of either. To me the Informa report was very beneficial. It contains important background data. I disagree with its recommendation that Lubbock should be added as a delivery point. It is not necessary that a delivery point be in a major production area. In my opinion it is important that delivery points be situated so that, if all other criteria are met, each major production area is close enough to a delivery point so that the producers in those major areas are not disadvantaged in the freight cost to deliver relative to producers in other major areas. If one looks at page 30 of the Informa report and draws a circle of a 300 mile radius around Greenville, S.C., Memphis, TN, and Dallas/Fort Worth, Texas, the major production areas of northeast North Carolina and southwest Georgia lie within Greenville's, the Mid-South lies within Memphis', and most of west Texas lies within Dallas/Fort Worth's. Interestingly, the existing delivery point of Houston is the same distance from Lubbock as is Corpus Christi. I believe that this rough equality in the hauling distance and thus in the cost to deliver is important not so that the futures become a de facto cash market, which would be disastrous, but because in times of excess supply the cash market is discounted more relative to futures than at other times. At least theoretically, the cash market should not be discounted to futures by an amount greater than the cost to deliver. Thus for a physical delivery agricultural market serving a large production area, it is incumbent upon the contract market to locate delivery points that roughly equalize the cost of delivery of the physical product between the major production areas. Thus I believe it is important for delivery points periodically to be examined to see if freight rates from major production areas are roughly equal. I believe that the addition of Dallas meets this criteria.

As I indicated in the first paragraph, Staplcotn is a major participant in the purchase and sale of cotton futures contracts and options on Ice Futures. Obviously we're always concerned about the status of the cotton market, and especially so after the events of the winter and spring of 2008. During that time there were unreasonable fluctuations and unwarranted changes to the upside in the price of cotton which placed an undue and unnecessary burden on interstate commerce in cotton. At its widest point the futures contract for delivery two months in the future was trading at approximately a twenty cent per pound premium to the cash level which cotton

could be sold to a textile mill for delivery in the same time frame. Normally this difference would fluctuate over a range of even to five cents per pound, cash under. I saw that there was an undue burden placed on interstate commerce in cotton because end users, the textile mills, could not find shippers (including Staplcotn) who were willing to sell them at a cash level basis so discounted to futures. Correspondingly, producers attempting to market their crops on hand or their crops to be harvested six months thereafter could not find shippers (including Staplcotn) willing to enter into contracts of purchase at all or at lease at a cash level (basis) in any way approaching historical basis levels. Contracts previously entered into were honored where financial resources were available. However, for a period of time additional interstate commerce in cotton ceased.

With the fresh look at legislation and regulation currently occurring, the Commission has an opportunity to take steps to assure that events like March, 2008, in cotton do not reoccur.

I believe a contributing factor to the debacle was the de facto removal of speculative position limits by the Exchange and the Commission by granting hedge exemptions to speculative position limits to index funds and swap dealers. We are all affected by whatever currently is in vogue. At that time it was in vogue to try to redefine these commodity contracts so that they would serve as much as investment vehicles as a means for discovering prices and transferring price risks. The results were disastrous.

These agricultural contract markets must be regulated only in order to comply with the Act. In an agricultural futures market, the number of true hedges of the physical commodity that can be placed in the contract market is finite because it is limited by the size of the crop and how much of that limited supply remains unconsumed. In recognition of this, speculative positions have always been limited so as to maintain some balance between the volume of speculative contracts and the volume of hedge contracts. The two “innovations” of the past decade – index funds and swap contracts – and the granting to them of hedge exemptions have destroyed this rough balance.

I believe the definition of a hedger in an agricultural contract market should be limited to a party who in his normal course of business takes title to the physical commodity as a producer, a distributor, or a consumer. The hedger would only be someone whose position in the contract market offsets a position in the cash market for the physical commodity. Under this definition index funds would not be hedgers. It is ridiculous to me for the Commission to allow a fund that takes a position only in a commodity index to be considered a hedger when it lays off the price risk in a contract market. The index funds are laying off the risk of a change in the futures market price of the commodity and not the risk of a change in the cash market price. A contract market position derived from a speculative position can not be other than a speculative position in the contract market.

Among those who enter into swap agreements are speculators in the contract market who are at the limit of their permitted speculative position in futures and/or options. If they want to add to their speculative position, they can do so by entering into a swap agreement. The counter party then is permitted to take a position in the contract market that is considered a hedge position. This has the same effect on the contract market price as if the speculator had directly exceeded his limits therein. Again, the swap dealer is laying off in the contract market the risk of a change in the futures market price and not the risk of a change in the cash market price of the commodity. Again, a contract market position derived from a speculative position can not be other than a speculative position in the contract market. Swap dealers should be forced by regulation to identify whether their counter-party’s position is a hedge or speculation, as the term

hedge is defined herein. In laying off counter-party risk where the counter party position is a true hedge, as defined above, the swap dealer should be allowed a hedge exemption. However, in laying off counter-party risk where the counter-party position is speculative, which means not fitting into the definition of a hedge as defined above, the swap dealer's position in the contract market should be defined as speculative. If this were adopted, the swap dealer's aggregate speculative position should be limited to the position allowed one speculator.

If the Commission were to adopt these suggestions, I believe that the perception would be that the spread between the futures and cash markets would be far less likely to become exaggerated, as it did in February and March of 2008, and the agricultural contract markets would be much more effective in fulfilling their obligations to the public as defined in the Act. Thank you,