

Underwood Cotton Co.

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From: Underwood Cotton Co.
1320 Texas Ave.
Lubbock, Texas

To: Commodity Futures Trading Commission

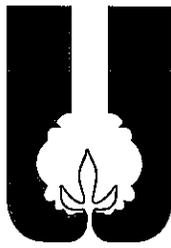
Purpose: Hedging Crisis in Dysfunctional Cotton Futures Market

My name is Alan Underwood and I have been in the cotton industry since 1973. I have 3 sons in business with me. We operate a cotton merchandising company in Lubbock, Texas that is structured in a conservative, highly disciplined manner and depends entirely on hedging cotton in the cotton futures market. Hedging is a requirement for the survival of our family business and a mandatory requirement for bank financing. I do apologize for the blunt, direct and to the point, style of presenting my written statement, but I am running out of time. I have been in this industry for over 30 years and all of the sudden someone changed the rules.

The CFTC will receive volumes of information from the financially injured hedgers on how to fix the current problems. In the written statements many of the participants will use terms that are important like "liquidity" and "price discovery", but the most important term in my company is "solvency". This is the term that is the most important of all and that is what I risk if I enter the futures market. Today if I take a position in futures it is an equal or higher risk than trading cash cotton. Instead of hedging my cash cotton I am doubling my speculative risk.

My solutions are simple and straight forward and require only in-house changes by the CFTC and ICE. Listed below, they are as follows:

- The use of synthetic price settlements from the options market to settle futures margin requirement must stop and not ever be used again. This practice puts an unfair burden on all traditional hedgers. The exchange must adopt a rule that requires clearing members to margin futures to the futures close and options to the options close.



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- Historically any person or company actively engaged in producing, merchandising, trading or spinning of cash cotton is a qualified hedger, everyone else was considered a speculator. No exceptions! The exchange must go back to this rule before it is too late. If any person or entity “bets on the direction of the price movement of the futures or options market,” they are clearly a speculator and should be confined to the current rules and limits set for speculators. This would balance the total number of trades. Currently the unrestricted volume of long orders from index funds crushes any legitimate supply and demand based hedger.
- Margin Requirements: Only the traditional hedgers, those persons or companies involved in the handling of cash cotton, shall be allowed to be margined as hedgers. Everyone else in the futures or options market shall be margined as a speculator. Margin requirements for speculators should be set closer to the full value of the futures. Hedgers have paid for the cotton and also paid for the margins. Speculators should be required to do much the same. The current margin requirements on speculators are so weak and diluted that it is encouraging extreme speculation in the futures and options market.
- Electronic trading versus open outcry: I believe an investigation will reveal that the closing of the open outcry pit and the conversion to electronic trading has fostered the manipulation of prices in a predatory manner against hedgers. When the pit closed we actually lost much of the transparency we already had. In an open pit the new “high frequency algorithmic trading” can not take place. In an open outcry pit one computer program can not play another computer program and move the market up or down like a video game. The open outcry in the pit changes the structure and timing of the orders and basically shuts down the game. Anyone trading the futures market recently should be able to testify to the strange and rhythmic flow of the current market. Floating up and down, quickly making price swings in minutes that use to take months. It is no longer driven by supply and demand, but by computer programs chasing each other in an endless computer game where traditional hedgers are nothing more than cannon fodder subject to unfair trade practices never before seen in this magnitude.



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The CFTC is being urged to act swiftly to correct the obvious problems in the cotton futures contract. This is not a problem that can be studied long term by a committee of nontraders for 2 years before they make watered down suggestions created to not offend index funds, investment banks, hedge funds, etc. We need a quick response and swift action. The undeniable fact for the CFTC is that this happened on your watch. We no longer have an exchange dedicated to customer service of the hedger. When the old exchange closed and ICE took over we lost one of our safeguards. The ICE is only interested in the value of their own stock. There are no provisions for protection of hedgers as we had in the past, we only have the CFTC. In the first paragraph of the CFTC website the CFTC responsibility and mandate are explained as “protecting market participants against fraud, manipulation, and abusive trading practices by ensuring the financial integrity of the clearing process.” That is a very comforting statement. The time has come for the CFTC to stand up to its mandate from congress. The CFTC is in the thick of it now and there is an entire cotton industry wanting answers. We want what we had only a short time ago, before there was an ICE or electronic trading. We want to have a futures market where we can hedge our risk. It is simple, Wall Street must find another Las Vegas or there will be no cotton industry left.

I respectfully submit this statement to the CFTC Agricultural Forum held April 22, 2008 in Washington, DC.

Sincerely,
Alan Underwood
President
Underwood Cotton Company