November 24, 2010

TO: Board of Directors, Kansas City Board of Trade
Members, Kansas City Board of Trade
The wheat futures hedging and trading community
Professional traders and market participants

RE: Support for KCBOT HRW contract changes to be voted on November 30, 2010

The undersigned individuals, whose cumulative experience amounts to hundreds of years of professional experience trading and hedging domestic and export cash wheat, support the proposed changes in the KCBOT HRW futures contract (vote scheduled for November 30).

Under the proposal, HRW delivery facilities will see a 61% increase in their storage rates (54 cents annually to 87 cents). These are returns far in excess of market rates and represent a potential economic windfall compared to competitors in the vastly larger country elevator marketplace outside the delivery areas. We recognize the necessity and value of participating warehouses in a physical delivery contract design like KCBOT, and we are willing to accept higher storage rates in exchange for their participation. However, it is a universally accepted principle that a viable futures contract must maintain balance between design features affecting both sides of the market – the long side interests as well as the short side. We are particularly pleased to see a protein requirement included as a modest offset to the increase in delivery storage rates. Our preference would be to see a unit-train load-out requirement as a further step toward balance, but we support that as a subsequent contract enhancement after evaluating the performance of the current proposal.

We note the ongoing campaign to pressure the members of the KCBOT into rejecting this proposal in order to backtrack into a variable storage rate (VSR) design like the CME has instituted. The entities promoting this are primarily warehouse interests (and their agents) who will benefit from the current proposal, yet still seem to want higher storage rates while objecting to improvements in contract terms for the potential taker of delivery stocks (e.g. 11.0% protein or unit train load-out).

Even the most ardent supporters of the VSR design must admit, as CME itself has done, that it is still an unproven mechanism. From our perspective, the inherent problems of VSR become more obvious by the month. SRW is largely uncompetitive in export markets in a bull-market demand year for US wheat. The returns for storing SRW are so immense that the export market cannot outbid the storage market, and domestic users are being forced to pay huge premiums to delivery value to source cash wheat. As this occurs, the VSR monthly rate is within days of expanding again to 14 cents/month, or $1.68/bushel/year! SRW is being priced out of consumption to such an extent that even delivery elevators have no cash outlet ahead of harvest to reduce or rotate their stocks (Toledo's new crop bid is 100 under the July, putting us "back to the beginning" with a new crop convergence issue). In our collective view, the problems highlighted above are only the beginning of a discussion on the disadvantages and negative implications of the VSR design. The SRW futures contract under the VSR model is collapsing in value as a hedging instrument.

As for the suggestion that an 11.0% protein requirement (with allowance to 10.5%) risks a squeeze in HRW delivery stocks in a low-protein crop year, this objection is not supported by the empirical data. Over the past 30 years, Kansas HRW weighted average protein is 12.09%, and 12.2% over the past 10 years. There is only one observation of the state's average weighted protein less than 11.0% and NEVER below 10.5%. If history were to be turned on its head and Kansas experienced a low protein crop, the very fact that the contract is 11.0% protein would actually strongly support convergence. Simply put, in a low protein year, by definition the 10.5/11.0% protein basis levels will be stronger and closer to option price. In the extreme case of a very low protein crop (which again, has NOT happened in last 30 years), we may actually see 10.5/11.0% protein trade at a premium to KCBOT option price. The CME has made mistake after mistake by never addressing their contract design and fairness issues (primarily vomitoxin in their case). We believe it would be an error for the KCBOT to make changes to storage rates that benefit the warehouseman without accommodating the long hedger with a modest and reasonable protein requirement.

We urge you to look at the facts when considering the current KCBOT proposal and the alternatives. This proposal is an excellent step that will improve convergence, avoid the VSR trap, and maintain balance in the KCBOT HRW contract that is critical to its longer term success.

Those of us who are members will vote yes on November 30, and we urge your support whether a KCBOT member or not.

Signed:

Jeff Ames	Erik Anderson	Tom Beringer	Ben Berte
Dan Brophy	Douglas Carper	Bob Cook	David Darr
Pete DeCicco	Jamie Dingley	Andrew Foote	Jerry Gerlach
Tom Grabowski	Michael L Greer	Parker Hansen	Richard Hartzell
Scott Hedin	Don Hills	Jim Kanan	Rob Kissick
Neal Kottke	Cliff Larson, Jr.	Cliff Larson, III	Gary Lubben
John Macintosh	David Massey	Jeffrey McPike	Rich Miller
Dixon Mooney	Colby Moss	Jim Neville	Paul Norris
Greg O'Brien	Mike Patterson	Jim Paulson	Dodd Pearson
Bruce Ritter	Dan Roemer	Morgan Shay	Matt Siegel
A Singhal	Brian Smith	Alex Smith	Lynda Soltis
Ken Stein	Bruce Wilson		

Cc: Commodity Futures Trading Commission, Washington DC