



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5260
Facsimile: (202) 418-5527
www.cftc.gov

Division of Market Oversight

CFTC letter No. 06-02
January 11, 2006
No-Action
Division of Market Oversight

Ms. Kristin M. Rebertus, Compliance Manager
Cargill Risk Management
Cargill, Incorporated
12700 Whitewater Drive
Minnetonka, MN 55343-9439

Re: Request for No-Action Relief with Regard to Section 32.13(a) of the Commission's
Regulations, Registration Requirements for Agricultural Trade Option Merchants

Dear Ms. Rebertus:

This is in response to your letter dated November 30, 2005, to the Division of Market Oversight (the "Division") as well as conversations with Division staff. By your correspondence you request on behalf of your employer, Cargill, Incorporated, that the Division provide written assurance that, if a to-be-formed, wholly-owned subsidiary of Cargill seeks and obtains registration as an agricultural trade option merchant ("ATOM"), the Division will not recommend enforcement action to the Commission for failure to comply with the provisions of Section 32.13(a) of the Commission's regulations, which limits ATOM registration to "a producer, processor, or commercial user of, or a merchant handling or selling inputs used in the production of, the commodity which is the subject of the option transaction ..."

The Facts

We understand the facts, as described in your no-action request, to be as follows: Cargill is an international provider of food, agricultural and risk management products and services, with 124,000 employees in 59 countries. Cargill's risk management business unit, Cargill Risk Management ("CRM"), develops products that assist producers, processors and commercial users of, and merchants handling or selling various commodities, or inputs used in the production of commodities, in managing their price risk. Cargill may deliver these price risk management products directly to qualified customers via over-the-counter derivatives ("OTCs") or indirectly, as components of formula pricing to be used to price commodities bought or sold by Cargill (the "Embedded Contract(s)"). At present, such contracts are being offered only in accordance with various exclusions or exemptions from the Commodity Exchange Act ("the Act") and CFTC regulations, including: in the case of Embedded Contracts, the forward contracts exclusion, Section 1a(19) of the Act; and in the case of OTC contracts, the swaps exemption, Section 35.2

of the regulations, and the exemption from the agricultural trade option rules found at Section 32.13(g) of the regulations.

Several potential Embedded Contract customers are or may be interested in engaging in OTC transactions with Cargill to hedge their commodity price risk but may not qualify to transact with Cargill on an OTC basis under current CFTC exemptive regulations, including the net worth requirements of Section 32.13(g)(1)(iii) of the agricultural trade option rules. In order to offer risk management tools to these customers, Cargill wishes to take advantage of the ATOM registration provisions.

ATOM registration entails reporting, accounting and other compliance requirements that, in light of the broad range of businesses operated within Cargill, are not workable for a very large privately held company. Therefore, Cargill intends to seek registration as an ATOM of a to-be-formed, wholly-owned subsidiary (the "Applicant").

Under Section 32.13(a), one of the conditions for registration as an ATOM is that the option offeror/registrant must be "a person who is a producer, processor, or commercial user of, or a merchant handling or selling inputs used in the production of, the commodity which is the subject of the commodity option transaction ..." Since the Applicant would be involved only in offering agricultural trade options involving physical commodities, but not in the handling of the physical commodities themselves, arguably it would not fall within a strict reading of the provisions of Section 32.13(a). However, you contend that ATOM registration of the Applicant would be within the general intent of the ATOM regulations.

In that context, you point to CFTC Interpretive Letter 03-36, November 4, 2003. In that letter, the Australian Wheat Board ("AWB") asked that its US subsidiary, AWBUS, be recognized as falling within the terms of the Section 32.13(g)(1)(i) exemption. The requirements for option offerees under that exemption and the requirements for ATOM registrants are substantively identical. (*See* Sections 32.13(a) and 32.13(g)(1)(i)) Both must be a "producer, processor, or commercial user of, or merchant handling ..." the commodity at issue. As noted in the Interpretive Letter, the AWB pointed out that, "While AWBUS would not be directly producing, processing, using or handling grain commodities, it would be performing related market-making financial transactions." The same is essentially true of the proposed activities of the Applicant, which would be performing related agricultural commodity related risk management financial transactions.

You note that, after reviewing the applicable statutory and regulatory history, the Division found that "AWBUS's proposed commercial wheat trading activities clearly fall within the Commission's intent," and thus would fall within the exemption, for the following three reasons:

- (1) AWBUS will be entering into option transactions solely for the purpose of facilitating the wheat trading activities of its corporate parent and affiliates;
- (2) the collective primary business purpose of AWBUS and its corporate parent and affiliates is the commercial trading of wheat commodities; and
- (3) AWBUS is sophisticated in the wheat trade and would have the means to tender or accept physical delivery of wheat, if necessary.

You contend that the same rationale is equally applicable to the Applicant and its corporate parent, Cargill, since: (1) the Applicant will be entering into options for the purpose of facilitating the grain trading and/or risk management activities of its parent, Cargill; (2) both entities would be substantially involved in the agricultural commodity trading business or its associated price risk management ; and (3) the Applicant could tender or accept physical delivery, if necessary.

Legal Analysis

The legislative and regulatory history relating to options on agricultural commodities is long and rather convoluted.¹ In 1936, responding to a history of price disruptions in the futures markets attributed to speculative trading in options, Congress completely prohibited options trading, both on- and off-exchange, in the specific list of enumerated agricultural commodities then under regulation.² In 1974, Congress passed the Commodity Futures Trading Commission Act, creating the Commission and giving it jurisdiction over futures trading in all commodities, as well as plenary authority to regulate the offer and sale of commodity options. The Commission undertook various regulatory initiatives with respect to options on the newly regulated commodities.³ The Commission's actions included exempting "trade options" from most regulation, except for the prohibition on fraud.⁴ However, the earlier prohibition on options trading in the enumerated agricultural commodities remained in place as a consequence of both statutory provision and Commission rule. *See* Commission Regulation 32.2. This prohibition extended to both exchange-traded options on agricultural commodities and off-exchange agricultural trade options.

In 1982, responding to the success of a Commission pilot program that had allowed exchange-traded options in the non-enumerated commodities, Congress repealed the statutory ban on options in the enumerated agricultural commodities. The following year, the Commission implemented a pilot program allowing the reintroduction of exchange-traded options on the enumerated agricultural commodities.⁵ However, "in light of the lack of recent experience with agricultural options and because the trading of exchange-traded options is subject to more comprehensive oversight"⁶ the Commission left in place the regulatory ban on (off-exchange) agricultural trade options.

¹ For a comprehensive review of this history, see the preamble to the Commission's Interim Final Rules for Trade Options on the Enumerated Agricultural Commodities, 63 FR 18821 (April 16, 1998).

² The specific agricultural commodities (generally referred to as the "enumerated commodities") listed in the 1936 Commodity Exchange Act ("the Act") included the grains, cotton, butter, eggs and potatoes. Later amendments to the Act added fats and oils, livestock, soybeans and other agricultural commodities.

³ These newly-regulated commodities, which first came under Commission jurisdiction under the 1974 Act, included financial instruments, currencies, energy products, metals and "non-enumerated" agricultural commodities such as coffee, sugar and cocoa.

⁴ A "trade option" is an off-exchange (over-the-counter) option offered to a commercial user who is entering into the option solely for purposes related to its business as such. *See* Commission Regulation 32.4.

⁵ 48 FR 46800 (October 14, 1983).

⁶ *Id.*

In June of 1997, the Commission published an advance notice of proposed rulemaking⁷ seeking comment on whether it should lift the prohibition on agricultural trade options and, if so, subject to what conditions. In November of 1997, the Commission published proposed rules to allow agricultural trade options.⁸ In April of 1998, the Commission published Interim Final Rules entitled, “Trade Options on the Enumerated Agricultural Commodities.”⁹ The rules lifted the ban on agricultural trade options, but permitted only those entities that handled the commodity in normal cash market channels to buy or sell such options and required vendors of such options to register with the Commission as “agricultural trade option merchants” (“ATOMs”) subject to various reporting, recordkeeping, disclosure and other requirements. Eligibility to register as an ATOM was restricted to “a person who is a producer, processor, or commercial user of, or a merchant handling or selling inputs used in the production of, the commodity which is the subject of the commodity option transaction, or the products or byproducts thereof ...”¹⁰

The issue raised by your letter is, then, whether Cargill’s subsidiary, the “Applicant,” falls sufficiently within the spirit of the ATOM registration rules – even if, strictly speaking, it might not fall within the letter of those rules – such that the Division should give its assurance that, if the Applicant sought and obtained registration as an ATOM, the Division would not recommend enforcement action to the Commission on the grounds that the Applicant failed to comply with the requirements of Section 32.13(a).

The Division notes that the Section 32.13(a) “producer, processor, or commercial user of, or a merchant handling” test, first appeared in the April 1998 Interim Final Rules. The test described eligible vendors who (provided they also met the other requirements of the regulations) would be allowed to register as ATOMS. The preamble to those rules made clear that the scope of the “producer, processor, merchant ...” language was not limited to “first handlers” of a commodity.

Although first handlers typically would be eligible to become agricultural trade option merchants, other categories of commercial users would also be eligible to apply for registration. ... Accordingly, grain merchants, investment bankers with active commodity trading operations and various types of agricultural processors or commercial users of the commodity might be eligible to register to operate as an agricultural trade option merchant.¹¹

Clearly, as used in the agricultural trade option regulations, the phrase, “producer, processor, or commercial user of, or a merchant handling” a commodity was intended to apply more broadly than to just first handlers of commodities. The Division believes that the Applicant, as a wholly-owned subsidiary of a grain merchant such as Cargill, is an appropriate candidate for inclusion within that broader application of the “producer, processor ...” category.

Conclusion

⁷ 62 FR 31375 (June 19, 1997).

⁸ 62 FR 59624 (November 4, 1997).

⁹ 63 FR 18821 (April 16, 1998).

¹⁰ The agricultural trade option regulations were further amended in 1999 (64 FR 68011, December 6, 1999), but the eligibility requirements for ATOM registration remained unchanged.

¹¹ Id. 63 FR 18821, at 18824.

Thus, it is the Division's conclusion, based upon the foregoing analysis and the representations in your letter, that granting the no-action relief requested would be within the spirit of the ATOM registration rules and would not be contrary to the public interest. Therefore, if Cargill's wholly-owned subsidiary, the Applicant, seeks and obtains registration as an ATOM (including meeting all the other requirements for registration), the Division will not recommend enforcement action to the Commission on the grounds that the Applicant failed to comply with the "producer, processor ... commercial user ... merchant handling ..." requirements of Section 32.13(a).

The position taken herein is based upon the representations you have made to the Division. Any different, changed or omitted facts or conditions might require the Division to reach a different conclusion. You must notify the Division immediately in the event that there is any significant change from the facts presented to us concerning Cargill's or the Applicant's agricultural risk management activities, as described in your letter. Further, this letter represents the position of the Division of Market Oversight only and does not necessarily represent the views of the Commission or any other division or office of the Commission.

If you have any questions concerning this correspondence, please contact Donald H. Heitman, an attorney on my staff, by email at dheitman@cftc.gov, or by phone at (202) 418-5041.

Very truly yours,

Richard A. Shilts
Director
Division of Market Oversight

cc: Gregory C. Prusik
Vice President, Registration
National Futures Association