



**PETROLEUM
MARKETERS
ASSOCIATION OF
AMERICA**

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June 26, 2012

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

Re: 17 CFR Parts 3, 32, and 33 Commodity Options; RIN 3038-AD62

I. Introduction

The Petroleum Marketers Association of America (“PMAA”) is a national federation of 48 state and regional trade associations representing over 8,000 independent petroleum marketing companies. These companies own 60,000 convenience store/gasoline stations and supply motor fuels, including gasoline and diesel fuel, to an additional 40,000 stores. PMAA members also sell at retail 90 percent of the home heating oil consumed in the United States.

Joining PMAA in these comments is the New England Fuel Institute (“NEFI”). NEFI is a member of PMAA and an independent trade association representing approximately 1,200 home heating businesses including heating oil, kerosene and propane dealers and related services companies, most of which are small, multi-generational family owned-and-operated-businesses. Many PMAA and NEFI members also market lubricants, jet fuels and racing fuels, as well as renewable fuels such as biofuels and other alternative energy products.

Under Section 721 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act” or “Act”), a new section 1a (47) was added to the Commodity Exchange Act (CEA), defining “swap” to include, “a commodity swap,” but also “an option of any kind that is for the purchase or sale, or based on the value, of 1 or more commodities.” The Commission issued an interim final rule that incorporates a trade option exemption into the final rules for commodity options (added Sec. 32.3). To obtain the trade option exemption, “the option, the offeror (seller), and the offeree (buyer), must satisfy certain eligibility requirements, including that the option, if exercised, be physically settled, that the option seller meet certain eligibility requirements, and that the option buyer be a commercial user of the commodity underlying the option, and certain other regulatory conditions.”¹

As the CFTC works to complete a final rule on this and other rules as required by the Dodd-Frank Act, it is important that Commissioners and their staffs acknowledge the important need to minimize regulatory compliance, reporting or cost burdens on motor fuel and heating fuel retailers, wholesalers, suppliers, jobbers, terminals and bulk storage companies. These companies are not financial entities, swap dealers or major swap participants as contemplated by the Congressional authors of the Act.² This is an outcome that the Commission and its staff have met in the final rule, but there are still some remaining issues that need to be resolved under the interim final rule.

II. Trade Option Exemption

Under the interim final rule, the Commission provides for a trade option exemption for physically-settled commodity options purchased by commercial users, subject to certain conditions, and requests comment on a few issues that could have unintended consequences for small business retail fuel companies. Questions such as:

¹ 17 CFR Parts 3, 32, and 33 Commodity Options; Final Rule and Interim Final Rule Federal Register / Vol. 77, No. 82; 4/27/2012

² Pub.L.111-203, §721

1. “Is the range of commodity option transactions that would qualify for the trade option exemption appropriate?” and
2. “By requiring that a trade option, when exercised, must result in the immediate (spot) or deferred (forward) shipment or delivery of an exempt or agricultural commodity, would the interim final rule improperly exclude other commodity option transactions, including other transactions with optionality, that should be eligible for a trade option exemption?”³

PMAA and NEFI urge the Commission to modify its trade option exemption under §32.3 to permit non-eligible contract participants (ECPs) to engage in off-exchange, bilateral and financially-settled options. This will increase competition and choice for small business gasoline, diesel and heating oil dealers as well as their customers. For many of these small commercial entities, the size of their physical positions is too small to take advantage of exchange-traded swaps or futures to hedge their price risk. Many PMAA and NEFI member companies buy call and put options which offer less than the standard contract volume (42,000 gallons). This makes risk management accessible while also allowing flexibility in choosing time period, location, volume and fuel specification. Therefore, absent the ability to enter into off-exchange financially-settled options, small businesses may be forced to either (1) accept unnecessary price risk, which may not be a viable option in volatile markets like heating oil/RBOB, or (2) purchase physical options from their wholesaler-suppliers due to the lack of competitive alternatives.

In small rural niche energy markets, barriers to entry into the physical business often results in little or no competition among physical wholesaler-suppliers. Financially-settled options, however, enable third-party hedging firms (e.g., aggregators⁴) to provide small market participants alternatives to the physical wholesaler-suppliers. In some cases, aggregators are the only alternative available to small market participants given that larger wholesaler distributors may not want to engage in risk management transactions with these small entities since they may lack credit worthiness. In other words, small market participants such as small business gasoline and heating oil dealers could potentially be held captive to wholesale marketers due to lack of competitive alternatives.

Although many small retailers and end users may qualify as ECPs, their net worth often can fluctuate, causing them to be unsure from time to time whether they satisfy the \$1,000,000 net worth threshold for commercial entities hedging risk. Moreover, an entity’s net worth may have an inverse relationship with its liabilities; that is as liabilities increase, possibly leading the entity to need to hedge, its net worth may decrease.

While PMAA and NEFI support the inclusion of a financially-settled trade option exemption in the final rule, we also stress to the Commission that the exemption should be narrowly tailored to avoid creating a loophole for the financial entities to exploit. Thus, the Commission should narrow the exception by limiting its application to financially-settled options that are of a smaller quantity than is offered on an exchange.

III. Trade Option Exemption to Non- Eligible Contract Participant Offerors

PMAA and NEFI also would like to address the trade option exemption for offerors that do not classify as ECPs. The Commission asks, “Is the scope of the trade option exemption offeror requirement in the interim final rule (i.e., offerors must be ECPs or commercials) appropriate?”

PMAA and NEFI member companies urge the Commission to modify the trade option exemption for offerors to enable aggregators to benefit from the trade option exemption in cases where they may not qualify as an ECP. Aggregators enable small business heating oil and gasoline dealers to hedge commercial risk in customized sizes that are not available on exchanges and often are smaller than large market participants are willing to trade. Aggregators typically work with small businesses that need to hedge volumes that are less than the standardized exchange-traded futures contract volume. They aggregate their clients’ individual long bona fide hedge positions by taking opposite short positions through OTC swaps with their clients. Having aggregated the clients’ risk, the aggregator invariably lays off its own risk in the highly regulated futures or options markets administered by the CME NYMEX Division. This service of offering customized increments depending on the needs of the client makes hedging accessible to businesses with small portfolios who otherwise could not establish a clean hedge using exchange-traded contracts.

³ 17 CFR Parts 3, 32, and 33 Commodity Options; Final Rule and Interim Final Rule Federal Register / Vol. 77, No. 82; VI. Request for Comment on Interim Final Rule 2.d.i.

⁴ Aggregators refers to an entity that aggregates small business counterparty risk by selling OTC, financially settled options with multiple customers and purchasing an equivalent total volume of exchange-cleared contracts.

Most aggregators are cooperatives or relatively small companies that specialize in niche commodity markets in discrete geographic regions. This service is vital for the risk management programs offered by gasoline/diesel distributors and home heating oil dealers who provide residential and commercial customers “pre-buy” and “fixed” or “cap” pricing programs that insulate energy consumers from costly price swings.

Small businesses that use risk management financially-settled trade options that are held captive to limits supply options benefit from the availability of aggregators that serve the sole purpose of aggregating customer risk and laying it off on exchanges. As discussed above, in addition to providing customized hedging solutions for small businesses, aggregators provide competition for physical wholesaler-suppliers by giving customers captive to the suppliers an avenue for hedging price risk. By enabling retailers to cap the price of heating oil and other refined products using derivatives provided by an aggregator, households and small businesses are given greater options to protect themselves from prices spikes during peak seasonal needs.

IV. Proposed Rule Language

§ 32.3 Trade options.

(a) Subject to paragraphs (b), (c), and (d) of this section, the provisions of the Act, including any Commission rule, regulation, or order thereunder, otherwise applicable to any other swap shall not apply to, and any person or group of persons may offer to enter into, enter into, confirm the execution of, maintain a position in, or otherwise conduct activity related to, any transaction in interstate commerce that is a commodity option transaction, provided that:

- (1) Such commodity option transaction must be offered by a person that has a reasonable basis to believe that the transaction is offered to an offeree as described in paragraph (a)(2) of this section. In addition, the offeror must be either:
 - (i) An eligible contract participant, as defined in section 1a(18) of the Act, as further jointly defined or interpreted by the Commission and the Securities and Exchange Commission or expanded by the Commission pursuant to section 1a(18)(C) of the Act; or
 - (ii) A producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity option transaction, or the products or byproducts thereof, or an aggregator, and such offeror is offering or entering into the commodity option transaction solely for purposes related to its business as such;
- (2) The offeree must be a producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity option transaction, or the products or byproducts, thereof, and such offeree is offered or entering into the commodity option transaction solely for purposes related to its business as such; and
- (3) The commodity option must be either (i) intended to be physically settled, so that, if exercised, the option would result in the sale of an exempt or agricultural commodity for immediate or deferred shipment or delivery; or, if intended to be financially settled, (ii) of a quantity that is less than is commonly traded on an exchange, and the offeree must be using the commodity option to hedge bona-fide commercial risk.

V. Conclusion

PMAA and NEFI support the Commission’s efforts in promulgating rules as crucial steps toward effective oversight of the commodity markets and implementation of new rules and regulations under the Dodd-Frank Act. However, we also feel compelled to urge the Commission to structure, implement and enforce a final rule that is mindful of small business energy providers that engage in financially-settled trade options to meet the effective risk management needs of their businesses and customers. We also urge the Commission to allow aggregators to benefit from the trade option exemption so they can continue to offer competitive risk management needs to its small business customers.

PMAA and NEFI also urge the Commission to ensure that the interim final rule does not inadvertently provide exclusions or “loopholes” that would allow certain market participants (e.g., financial entities, swap dealers and major swap participants) to evade regulation or to exclude contracts, agreements and transactions that are speculative in nature, that are linked to futures, options or swaps that affect price discovery, contribute to extreme market volatility or speculation, or are done with the intent to manipulate or defraud.

We would be happy to discuss the above comments in detail or answer any questions the Commissioners or their staff may have. Please feel free to contact PMAA Vice President Sherri Stone at (703) 351-8000 or NEFI Vice President for Government Affairs Jim Collura at (202) 584-0160. Thank you in advance for your consideration and for the opportunity to comment on the proposed rules.

Respectfully submitted,



Dan Gilligan
President, PMAA



Michael C. Trunzo
President & CEO, NEFI

cc: The Honorable Gary Gensler, Chairman, Commodity Futures Trading Commission
The Honorable Michael Dunn, Commissioner, Commodity Futures Trading Commission
The Honorable Jill Sommers, Commissioner, Commodity Futures Trading Commission
The Honorable Bart Chilton, Commissioner, Commodity Futures Trading Commission
The Honorable Scott O'Malia, Commissioner, Commodity Futures Trading Commission
The Honorable Lisa Jackson, Administrator, Environmental Protection Agency
The Honorable Frank Lucas, Chairman and Collin Peterson, Ranking Member,
U.S. House of Representatives Committee on Agriculture
The Honorable Debbie Stabenow, Chairman and Pat Roberts, Ranking Member,
U.S. Senate Committee on Agriculture, Nutrition & Forestry