

## CFTC FINAL RULES ON COMMODITY OPTIONS

April 20, 2012

To Our Clients and Friends:

On April 18, 2012, the Commodity Futures Trading Commission (the “CFTC”) adopted the final rule on commodity options, which will generally permit market participants to trade commodity options subject to the same rules applicable to all other swaps, and adopted the interim final rule on the trade option exemption for physically delivered commodity options purchased by commercial users subject to certain conditions.

### TRADING OF COMMODITY OPTIONS IN GENERAL

Section 1a(47) of the Commodity Exchange Act (the “CEA”), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, defines “swap” to include an “option of any kind that is for the purchase or sale, or based on the value, of 1 or more...commodities.” In February 2011, the CFTC proposed to treat all commodity options in the same manner as all other swaps and to repeal or modify all existing rules on commodity options under its plenary rulemaking authority over all commodity options pursuant to section 4c(b) of the CEA.

The final rule adds new part 32 to the CFTC regulations, which will permit all commodity options to be transacted subject to the same rules applicable to all other swaps. This removes any regulatory uncertainty as to whether section 4c(b) of the CEA would otherwise prohibit commodity options. Therefore, any person is permitted to transact commodity options on or subject to the rules of a designated contract market, while only an eligible contract participant (“ECP”) is permitted to transact commodity options bilaterally or on a swap execution facility.

The final rule contains a general antifraud provision for commodity options, which prohibits any person, in connection with a commodity option transaction, from directly or indirectly (1) cheating or defrauding or attempting to cheat or defraud any other person, (2) making or causing to be made to any other person any false report or statement thereof or (3) deceiving or attempting to deceive any other person by any means. This antifraud provision is in line with the CFTC’s other antifraud rules as to the scienter requirement (“intentionally or with reckless disregard”).

## TRADE OPTION EXEMPTION

Section 32.3 of the CFTC regulations, adopted as an interim final rule, provides an exemption from certain of the swap regulations for trade options on exempt commodities (such as energy and metal commodities) and agricultural commodities (such as grain and soft commodities) if the parties to and the characteristics of commodity options meet certain requirements, subject to specified ongoing conditions and compliance requirements.

In order to be eligible for the trade option exemption, the offeror of a commodity option must be either (1) an ECP or (2) a producer, processor, or commercial user of, or merchant handling the commodity that is the subject of the commodity option, or the products or by-products thereof, and such offeror is offering or entering into the commodity option solely for purposes related to its business as such. 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, or the products or by-products thereof, and such offeree is offered or entering into the commodity option solely for purposes related to its business as such. And, the offeror must have a reasonable basis to believe that the commodity option is offered to the type of offeree described above.

In addition, the commodity option must be 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. In other words, the obligations remaining or created upon exercise must be a spot transaction or fall within the forward contract exclusion from the swap definition.

An offeree of a commodity option does not have to be an ECP, but if an offeree is an ECP that is not a producer or other commercial party described above, the exemption will not be available.

While most of the swap regulations do not apply with respect to trade options, certain of such regulations will apply to each trade option counterparty to the same extent such regulations would apply to such person in connection with any other swap as a condition for reliance on the trade option exemption. According to the CFTC, these conditions are intended to preserve a level of market visibility for the CFTC with reduced compliance burden for market participants.

Such applicable regulations include: part 20 (large trader reporting); part 151 (position limits); subpart J of part 23 (duties of swap dealers and major swap participants); sections 23.200 through 23.204 (reporting and recordkeeping requirements for swap dealers and major swap

participants); and section 4s(e) of the CEA (capital and margin requirements for swap dealers and major swap participants).

Each counterparty to a trade option must comply with recordkeeping requirements under part 45. Also, each counterparty must comply with reporting requirements under part 45 to the extent that at least one counterparty has become obligated to comply with such reporting requirements as a part 45 reporting party during the 12-month period preceding the date on which a trade option is entered into in connection with any swap other than a trade option. Therefore, if only one counterparty has previously complied with the part 45 reporting obligations, then such counterparty must report the information on the trade option pursuant to part 45. If both counterparties have previously complied with the part 45 reporting obligations, then the part 45 rules will determine the part 45 reporting party for the trade option. If neither party has previously complied with the part 45 reporting obligations, then the trade option is not required to be reported pursuant to part 45. However, in that case, each of the counterparties will be required to submit an annual filing to the CFTC by completing and submitting Form TO (Annual Notice Filing for Counterparties to Unreported Trade Options) by March 1 following the end of a calendar year during which such counterparty entered into one or more unreported trade options. Form TO will include information on the category of commodities underlying the relevant trade options and on the approximate aggregate value of commodities delivered or received in connection with the exercise of such trade options.

#### EFFECTIVE DATE AND COMPLIANCE DATE

The final rule and interim final rule will become effective 60 days after their publication in the Federal Register. The compliance date for these rules will be 60 days after the publication of the final rule on the definition of “swap.” However, for the purpose of complying with (1) the final rule that permits entering into commodity options transactions in compliance with and subject to the provisions of the CEA, including any CFTC rule, regulation, or order, applicable to any other swap, and (2) the conditions and provisions of the trade option exemption, the compliance date will be the compliance date associated with any such swaps rules. In other words, notwithstanding the effective or compliance date described above, market participants need not comply with any applicable conditions referencing a swap rule, regulation, or order, until such time as the rule, regulation, or order is applicable to any other swap. In addition, the first compliance date for the Form TO notice filing requirement will be for the calendar year beginning January 1, 2013. Therefore, counterparties to unreported trade options are required

to submit a Form TO in connection with their unreported trade options entered into between January 1 and December 31, 2013 on or before March 1, 2014. There is no Form TO filing requirement for unreported trade options entered into between the effective date of the interim final rule and December 31, 2012.

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Please call me if you have any questions or wish to discuss the final rules in greater detail.

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