APPENDIX B TO PART 151—EXAMPLES OF BONA FIDE HEDGING TRANSACTIONS AND POSITIONS

A non-exhaustive list of examples of bona fide hedging transactions or positions under §151.5 is presented below. A transaction or position qualifies as a bona fide hedging transaction or position when it meets the requirements under §151.5(a)(1) and one of the enumerated provisions under §151.5(a)(2). With respect to a transaction or position that does not fall within an example in this appendix, a person seeking to rely on a bona fide hedging transaction or position when it meets the requirements under §151.5(a)(2)(vi), one of the provisions under §151.5(a)(1) and one of the enumerated provisions under §151.5(a)(2). With respect to a transaction or position that does not fall within an example in this appendix, a person seeking to rely on a bona fide hedging transaction or position when it meets the requirements under §151.5(a)(2)(vi), one of the provisions under §151.5(a)(1) and one of the enumerated provisions under §151.5(a)(2). With respect to a transaction or position that does not fall within an example in this appendix, a person seeking to rely on a bona fide hedging transaction or position when it meets the requirements under §151.5(a)(2)(vi), one of the provisions under §151.5(a)(1) and one of the enumerated provisions under §151.5(a)(2). With respect to a transaction or position that does not fall within an example in this appendix, a person seeking to rely on a bona fide hedging transaction or position when it meets the requirements under §151.5(a)(2)(vi), one of the provisions under §151.5(a)(1) and one of the enumerated provisions under §151.5(a)(2).

1. Royalty Payments
   a. Fact Pattern: In order to develop an oil field, Company A approaches Bank B for financing. To facilitate the loan, Bank B first establishes an independent legal entity commonly known as a special purpose vehicle (SPV). Bank B then provides a loan to the SPV. Payments of principal and interest from the SPV to the Bank are based on a fixed price for crude oil. The SPV in turn makes a production loan to Company A. The terms of the production loan require Company A to provide the SPV with volumetric production payments (VPPs) based on the SPV’s share of the production and the prevailing price of crude oil. Because the price of crude may fall, the SPV reduces that risk by entering into a NYMEX Light Sweet Crude Oil Referenced Contract swap with Swap Dealer C. The swap requires the SPV to pay Swap Dealer C the floating price of crude oil and for Swap Dealer C to pay a fixed price. The notional quantity for the swap is equal to the expected production underlying the VPPs to the SPV.
   Analysis: The swap represents a substitute for transactions to be made in the physical marketing channel. The SPV’s swap position qualifies as a hedge because it is economically appropriate to the reduction of risk. The SPV is reasonably certain that the notional quantity of the swap is equal to the expected production underlying the VPPs. The swap reduces the risk associated with a change in value of a royalty asset. The fluctuations in value of the SPV’s anticipated royalties are substantially related to the fluctuations in value of the NYMEX Light Sweet Crude Oil Referenced Contract swap with Swap Dealer C. The risk-reducing position qualifies as a bona fide hedge in a physical-delivery Referenced Contract during the spot month.
   b. Continuation of Fact Pattern: Swap Dealer C offsets the risk associated with the swap to the SPV by selling Referenced Contracts. The notional quantity of the Referenced Contracts sold by Swap Dealer C exactly matches the notional quantity of the swap with the SPV.
   Analysis: Because the SPV enters the swap as a bona fide hedger under §151.5(a)(2)(vi), the offset of the risk of the swap in a Referenced Contract by Swap Dealer C qualifies as a bona fide hedging transaction under §151.5(a)(3). As provided in §151.5(a)(3), the risk reducing position of Swap Dealer C does not qualify as a bona fide hedge in a physical-delivery Referenced Contract during the spot month.

2. Sovereigns
   a. Fact Pattern: A Sovereign induces a farmer to sell his anticipated production of 100,000 bushels of corn forward to User A at a fixed price for delivery during the expected harvest. In return for the farmer entering into the fixed-price forward sale, the Sovereign agrees to pay the farmer the difference between the market price at the time of harvest and the price of the fixed-price forward. In the event that the market price is above the price of the forward. The fixed-price forward sale of 100,000 bushels of corn reduces the farmer’s downside price risk associated with his anticipated agricultural

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**Contract**

| New York Mercantile Exchange Palladium | 650 |
| New York Mercantile Exchange Platinum | 3,000 |
| Commodity Exchange, Inc. Gold | 1,500 |

**Energy Referenced Contracts**

| New York Mercantile Exchange Light Sweet Crude Oil | 3,000 |
| New York Mercantile Exchange New York Harbor Gasoline Blendstock | 1,000 |
| New York Mercantile Exchange Henry Hub Natural Gas | 1,000 |
| New York Mercantile Exchange New York Harbor Heating Oil | 1,000 |
production. The Sovereign faces commodity price risk as it stands ready to pay the farmer the difference between the market price and the price of the fixed-price contract. To reduce that risk, the Sovereign purchases 100,000 bushels of Chicago Board of Trade ("CBOT") Corn Referenced Contract call options.

Analysis: Because the Sovereign and the farmer are acting together pursuant to an express agreement, the aggregation provisions of §151.7 and §151.5(b) apply and they are treated as a single person. Taking the positions of the Sovereign and farmer jointly, the risk profile of the combination of the forward sale and the long call is approximately equivalent to the risk profile of a synthetic long put. A synthetic long put may be a bona fide hedge for anticipated production. Thus, that single person satisfies the general requirements for bona fide hedging transactions (§151.5(a)(1)(i)–(iii)) and specific requirements for anticipated agricultural production (§151.5(a)(2)(i)(B)). The synthetic long put is a substitute for transactions that the farmer will make at a later time in the physical marketing channel after the crop is harvested. The synthetic long put reduces the price risk associated with anticipated agricultural production. The size of the hedge is equivalent to the size of the Sovereign's risk exposure. As provided under §151.5(a)(2)(i)(B), the Sovereign's risk-reducing position will not qualify as a bona fide hedge in a physical-delivery Referenced Contract during the last five trading days.

3. SERVICES

a. Fact Pattern: Company A enters into a risk service agreement to drill an oil well with Company B. The risk service agreement provides that a portion of the revenue receipts to Company A depends on the value of the oil produced. Company A is concerned that the price of oil may fall resulting in lower anticipated revenues from the risk service agreement. To reduce that risk, Company A sells 5,000 NYMEX Light Sweet Crude Oil Referenced Contracts, which is equivalent to the firm’s anticipated share of the oil produced. Selling NYMEX Light Sweet Crude Oil Referenced Contracts is a substitute for transactions to be taken at a later time in the physical marketing channel once the oil is produced. The Referenced Contracts sold by Company A are economically appropriate to the reduction of risk because the total notional quantity of the Referenced Contracts sold by Company A equals the share of the expected quantity of future production under the risk service agreement.

Analysis: This transaction meets the general requirements for bona fide hedging transactions (§151.5(a)(1)(i)–(iii)) and the specific provisions for services (§151.5(a)(2)(vii)). Because the City is responsible for paying the cash price for the natural gas used to transport the solid waste by the trucks that transport the solid waste under the services agreement, the long hedge is a substitute for transactions to be taken at a later time in the physical marketing channel. The transaction is economically appropriate to the reduction of risk because the total notional quantity of the positions Referenced Contracts purchased equals the expected use of natural gas over the life of the contract. The positions in Referenced Contracts reduce the risk associated with an increase in anticipated liabilities that the City may incur in the event that the price of natural gas increases. The service contract involves the use of a commodity underlying a Referenced Contract. As provided under §151.5(a)(2)(vii), the risk reducing position will not qualify as a bona fide hedge during the spot month of the physical-delivery Referenced Contract.

b. Fact Pattern: A City contracts with Firm A to provide waste management services. The contract requires that the trucks used to transport the solid waste use natural gas as a power source. According to the contract, the City will pay the cost of the natural gas used to transport the solid waste by Firm A. In the event that natural gas prices rise, the City’s waste transport expenses rise. To mitigate this risk, the City establishes a long position in NYMEX Natural Gas Referenced Contracts that is equivalent to the expected use of natural gas over the life of the service contract.

Analysis: This transaction meets the general requirements for bona fide hedging transaction (§151.5(a)(1)(i)–(iii)) and the specific provisions for services (§151.5(a)(2)(vii)). Because the City is responsible for paying the cash price for the natural gas used to power the trucks that transport the solid waste under the services agreement, the long hedge is a substitute for transactions to be taken at a later time in the physical marketing channel. The transaction is economically appropriate to the reduction of risk because the total notional quantity of the positions Referenced Contracts purchased equals the expected use of natural gas over the life of the contract. The positions in Referenced Contracts reduce the risk associated with an increase in anticipated liabilities that the City may incur in the event that the price of natural gas increases. The service contract involves the use of a commodity underlying a Referenced Contract. As provided under §151.5(a)(2)(vii), the risk reducing position will not qualify as a bona fide hedge during the spot month of the physical-delivery Referenced Contract.

c. Fact Pattern: Natural Gas Producer A induces Pipeline Operator B to build a pipeline between Producer A’s natural gas wells and the Henry Hub pipeline interconnection by entering into a fixed-price contract for natural gas transportation that guarantees a specified quantity of gas to be transported over the pipeline. With the construction of the new pipeline, Producer A plans to deliver

521 Put-call parity describes the mathematical relationship between price of a put and call with identical strike prices and expiry.
natural gas to Henry Hub at a price differential between his gas wells and Henry Hub that is higher than its transportation cost. Producer A is concerned, however, that the price differential may decline. To lock in the price differential, Producer A decides to sell outright NYMEX Henry Hub Natural Gas Referenced Contract cash-settled futures contracts and buy an outright swap that NYMEX Henry Hub Natural Gas at his gas wells.

Analysis: This transaction satisfies the general requirements for a bona fide hedge exemption (§§151.5(a)(1)(i)–(iii)) and specific provisions for services (§151.5(a)(2)(vii)). The hedge represents a substitute for transactions to be taken in the future (e.g., selling natural gas at Henry Hub). The hedge is economically appropriate to the reduction of risk that the location differential will decline, provided the hedge is not larger than the quantity equivalent of the cash market commodity to be produced and transported. As provided under §151.5(a)(2)(vii), the risk reducing position will not qualify as a bona fide hedge during the spot month of the physical-delivery Referenced Contract.

4. LENDING A COMMODITY
a. Fact Pattern: Bank B lends 1,000 ounces of gold to Jewelry Fabricator J at LIBOR plus a differential. Under the terms of the loan, Jewelry Fabricator J may later purchase the gold at a differential to the prevailing price of Commodity Exchange, Inc. (“COMEX”) Gold (i.e., an open-price purchase agreement embedded in the terms of the loan). Jewelry Fabricator J intends to use the gold to make jewelry and reimburse Bank B for the loan using the proceeds from jewelry sales. Because Bank B is concerned about its potential loss if the price of gold drops, it reduces the risk of a potential loss in the value of the gold by selling COMEX Gold Referenced Contracts with an equivalent notional quantity of 1,000 ounces of gold.

Analysis: This transaction meets the general bona fide hedge exemption requirements (§§151.5(a)(1)(i)–(iii)) and the specific requirements associated with owning a cash commodity (§151.5(a)(2)(i)). Bank B’s short hedge of the gold represents a substitute for a transaction to be made in the physical marketing channel. Because the total notional quantity of the amount of gold contracts sold is equal to the amount of gold that Bank B owns, the hedge is economically appropriate to the reduction of risk. Finally, the transactions in Referenced Contracts arise from a potential change in the value of the gold owned by Bank B.

b. Fact Pattern: Silver Processor A agrees to purchase scrap metal from a Scrap Yard that will be processed into 5,000 ounces of silver. To finance the purchase, Silver Processor A borrows 5,000 ounces of silver from Bank B and sells the silver in the cash market. Using the proceeds from the sale of silver in the cash market, Silver Processor A pays the Scrap Yard for the scrap metal containing 5,000 ounces of silver at a negotiated discount from the current spot price. To repay Bank B, Silver Processor A may either: Provide Bank B with 5,000 ounces of silver and an interest payment based on a differential to LIBOR; or repay the Bank at the current COMEX Silver settlement price plus an interest payment based on a differential to LIBOR (i.e., an open-price purchase agreement). Silver Processor A processes and refines the scrap to repay Bank B. Although Bank B has lent the silver, it is still exposed to a reduction in value if the price of silver falls. Bank B reduces the risk of a possible decline in the value of their silver asset over the loan period by selling COMEX Silver Referenced Contracts with a total notional quantity equal to 5,000 ounces.

Analysis: This transaction meets the general requirements for a bona fide hedging transaction (§§151.5(a)(1)(i)–(iii)) and specific provisions for owning a commodity (§151.5(a)(2)(i)). Bank B’s hedge of the silver that it owns represents a substitute for a transaction in the physical marketing channel. The hedge is economically appropriate to the reduction of risk because the bank owns 5,000 ounces of silver. The hedge reduces the risk of a potential change in the value of the silver that it owns.

5. PROCESSOR MARGINS
a. Fact Pattern: Soybean Processor A has a total throughput capacity of 100 million tons of soybeans per year. Soybean Processor A “crushes” soybeans into products (soybean oil and meal). It currently has 20 million tons of soybeans in storage and has offset that risk through fixed-price forward sales of the amount of products expected to be produced from crushing 20 million tons of soybeans, thus locking in the crushing margin on 20 million tons of soybeans. Because it has consistently operated its plant at full capacity over the last three years, it anticipates purchasing another 80 million tons of soybeans over the next year. It has not sold the crushed products forward. Processor A faces the risk that the difference in price between soybeans and the crushed products could change such that crush products (i.e., the crush spread) will be insufficient to cover its operating margins. To lock in the crush spread, Processor A purchases 80 million tons of CBOT Soybean Referenced Contracts.

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Note that in addition to the use of Referenced Contracts, Producer A could have hedged this risk by using a basis contract, which is excluded from the definition of Referenced Contracts.
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and sells CBOT Soybean Meal and Soybean Oil Referenced Contracts, such that the total notional quantity of soybean meal and oil Referenced Contracts equals the expected production from crushing soybeans into soybean meal and oil respectively.

Analysis: These hedging transactions meet the general requirements for bona fide hedging transactions (§§151.5(a)(1)(i)–(iii)) and the specific provisions for unfilled anticipated requirements and unsold anticipated agricultural production (§§151.5(a)(2)(i)–(ii)). Purchases of soybean Referenced Contracts qualify as bona fide hedging transaction provided they do not exceed the unfilled anticipated requirements of the cash commodity for one year (in this case 80 million tons). Such transactions are a substitute for purchases to be made at a later time in the physical marketing channel and are economically appropriate to the reduction of risk. The transactions in Referenced Contracts arise from a potential change in the value of soybeans that the processor anticipates owning. The size of the permissible hedge position in soybeans must be reduced by any inventories and fixed-price purchases because they are no longer unfilled requirements. As provided under §151.5(a)(2)(ii)(C), the risk reduction position that is not in excess of the anticipated requirements for soybeans for that month and the next succeeding month qualifies as a bona fide hedge during the last five trading days provided it is not in a physical-delivery Referenced Contract.

Given that Soybean Processor A has purchased 80 million tons worth of CBOT Soybean Referenced Contracts, it can reduce its processing risk by selling soybean meal and oil Referenced Contracts equivalent to the expected production. The sale of CBOT Soybean, Soybean Meal, and Soybean Oil contracts represents a substitute for transactions to be taken at a later time in the physical marketing channel by the soybean processor. Because the amount of soybean meal and oil Referenced Contracts sold forward by the soybean processor corresponds to expected production from 80 million tons of soybeans, the hedging transactions are economically appropriate to the reduction of risk in the conduct and management of the commercial enterprise. These transactions arise from a potential change in the value of soybean meal and oil that is expected to be produced. The size of the permissible hedge position in the products must be reduced by any fixed-price sales because they are no longer unsold production. As provided under §151.5(a)(2)(i)(B), the risk reducing position does not qualify as a bona fide hedge in a physical-delivery Referenced Contract during the last five trading days in the event the anticipated crushed products have not been produced.

6. PORTFOLIO HEDGING

a. Fact Pattern: It is currently January and Participant A owns five million bushels of corn located in its warehouses. Participant A has entered into fixed-price forward sale contracts with several processors for a total of five million bushels of corn that will be delivered in May of this year. Participant A has separately entered into fixed-price purchase contracts with several merchandisers for a total of two million bushels of corn to be delivered in March of this year. Participant A’s gross long position is equal to seven million bushels of corn. Because Participant A has sold forward five million bushels of corn, its net cash position is equal to long two million bushels of corn. To reduce its price risk, Participant A chooses to sell the quantity equivalent of two million bushels of CBOT Corn Referenced Contracts.

Analysis: The cash position and the fixed-price forward sale and purchases are all in the same crop year. Participant A currently owns five million bushels of corn and has effectively sold that amount forward. The firm is concerned that the remaining amount—two million bushels worth of fixed-price purchase contracts—will fall in value. Because the firm’s net cash position is equal to long two million bushels of corn, the firm is exposed to price risk. Selling the quantity equivalent of two million bushels of CBOT Corn Referenced Contracts satisfies the general requirements for bona fide hedging transactions (§§151.5(a)(1)(i)–(iii)) and the specific provisions associated with owning a commodity (§151.5(a)(2)(i)). Participant A’s hedge of the two million bushels represents a substitute to a fixed-price forward sale at a later time in the physical marketing channel. The transaction is economically appropriate to the reduction of risk because the amount of Referenced Contracts sold does not exceed the quantity equivalent risk exposure (on a net basis) in the cash commodity in the current crop year. Lastly, the hedge arises from a potential change in the value of corn owned by Participant A.

7. ANTICIPATED MERCHANDISING

a. Fact Pattern: Elevator A, a grain merchandiser, owns a 31 million bushel storage facility. The facility currently has 1 million bushels of corn in storage. Based upon its historical purchasing and selling patterns for the last three years, Elevator A expects that in September it will enter into fixed-price

523 Participant A could also choose to hedge on a gross basis. In that event, Participant A would sell the quantity equivalent of seven million bushels of March Chicago Board of Trade Corn Referenced Contracts, and separately purchase the quantity equivalent of five million bushels of May Chicago Board of Trade Corn Referenced Contracts.
forward purchase contracts for 30 million bushels of corn that it expects to sell in December. Currently the December corn futures price is substantially higher than the September corn futures price. In order to reduce the risk that its unfilled storage capacity will not be utilized over this period and in turn reduce Elevator A’s profitability, Elevator A purchases the quantity equivalent of 30 million bushels of September CBOT Corn Referenced Contracts and sells 30 million bushels of December CBOT Corn Referenced Contracts.

Analysis: This hedging transaction meets the general requirements for bona fide hedging transactions (§§151.5(a)(1)(i)–(iii)) and specific provisions associated with anticipated merchandising (§151.5(a)(2)(v)). The hedging transaction is a substitute for transactions to be taken at a later time in the physical marketing channel. The hedge is economically appropriate to the reduction of risk associated with the firm’s unfilled storage capacity because: (1) The December CBOT Corn futures price is substantially above the September CBOT Corn futures price; and (2) Elevator A reasonably expects to engage in the anticipated merchandising activity based on a review of its historical purchasing and selling patterns at that time of the year. The risk arises from a change in the value of an asset that the firm owns. As provided by §151.5(a)(2)(v), the size of the hedge is equal to the firm’s unfilled storage capacity relating to its anticipated merchandising activity. The purchase and sale of offsetting Referenced Contracts are in different months, which settle in not more than twelve months. As provided under §151.5(a)(2)(v), the risk reducing position will not qualify as a bona fide hedge in a physical-delivery Referenced Contract during the last 5 trading days of the September contract.

8. AGGREGATION OF PERSONS

a. Fact Pattern: Company A owns 100 percent of Company B. Company B currently owns 1 million bushels of wheat. To reduce some of its price risk, Company B decides to sell the quantity equivalent of 600,000 bushels of CBOT Wheat Referenced Contracts. After communicating with Company B, Company A decides to sell the quantity equivalent of 400,000 bushels of CBOT Wheat Referenced Contracts.

Analysis: Because Company A owns more than 10 percent of Company B, Company A and B are aggregated together as one person under §151.7. Under §151.5(b), entities required to aggregate accounts or positions under §151.7 shall be considered the same person for the purpose of determining whether a person or persons are eligible for a bona fide hedge exemption under paragraph §151.5(a). The sale of wheat Referenced Contracts by Company A and B meets the general requirements for bona fide hedging transactions (§§151.5(a)(1)(i)–(iii)) and the specific provisions for owning a cash commodity (§151.5(a)(2)(i)). The transactions in Referenced Contracts by Company A and B represent a substitute for transactions to be taken at a later time in the physical marketing channel. The transactions in Referenced Contracts by Company A and B are economically appropriate to the reduction of risk because the combined total of 1,000,000 bushels of CBOT Wheat Referenced Contracts sold by Company A and Company B does not exceed the 1,000,000 bushels of wheat that is owned by Company A. The risk exposure for Company A and B results from a potential change in the value of wheat.

9. REPURCHASE AGREEMENTS

a. Fact Pattern: When Elevator A purchased 500,000 bushels of wheat in April it decided to reduce its price risk by selling the quantity equivalent of 500,000 bushels of CBOT Wheat Referenced Contracts. Because the price of wheat has steadily risen since April, Elevator A has had to make substantial maintenance margin payments. To alleviate its concern about further margin payments, Elevator A decides to enter into a repurchase agreement with Bank B. The repurchase agreement involves two separate contracts: A fixed-price sale from Elevator A to Bank B at today’s spot price; and an open-priced purchase agreement that will allow Elevator A to repurchase the wheat from Bank B at the prevailing spot price three months from now. Because Bank B obtains title to the wheat under the fixed-price purchase agreement, it is exposed to price risk should the price of wheat drop. It therefore decides to sell the quantity equivalent of 500,000 bushels of CBOT Wheat Referenced Contracts.

Analysis: Bank B’s hedging transaction meets the general requirements for bona fide hedging transactions (§§151.5(a)(1)(i)–(iii)) and the specific provisions for owning the cash commodity (§151.5(a)(2)(i)). The sale of Referenced Contracts by Bank B is a substitute for a transaction to be taken at a later time in the physical marketing channel either to Elevator A or to another commercial party. The transaction is economically appropriate to the reduction of risk in the conduct and management of the commercial enterprise of Bank B because the notional quantity of Referenced Contracts sold by Bank B is not larger than the quantity of cash wheat purchased by Bank B. Finally, the purchase of CBOT Wheat Referenced Contracts reduces the risk associated with owning cash wheat.
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§ 155.2 Trading standards for floor brokers.

Each contract market shall adopt rules which shall, at a minimum, with respect to each member of the contract market acting as a floor broker:

(a) Prohibit such member from purchasing any commodity for future delivery, purchasing any call option, or selling any put option, for his own account or for any account in which he has an interest, while holding an order of another person for the (1) purchase of any future, (2) purchase of any call option, or (3) sale of any put option, in the same commodity which is executable at the market price or at the price at which such purchase or sale can be made for the member’s own account or any account in which he has an interest.

(b) Prohibit such member from selling any commodity for future delivery, selling any call option, or purchasing any put option, for his own account or for any account in which he has an interest, while holding an order of another person for the (1) sale of any future, (2) sale of any call option, or (3) purchase of any put option, in the same commodity which is executable at the market price or at the price at which such sale or purchase can be made for the member’s own account or any account in which he has an interest.

(c) Prohibit such member from executing any transaction for any account of another person for which buying and/or selling orders can be placed or originated, or for which transactions can be executed, by such member without the prior specific consent of the account owner, regardless of whether the general authorization for such orders or transactions is pursuant to a written agreement, except that orders for such an account may be placed with another member for execution.

(d) Prohibit such member from disclosing at any time that he is holding an order of another person or from divulging any order revealed to him by reason of his relationship to such other person, except pursuant to paragraph (c) of this section or at the request of an authorized representative of the Commission or the contract market.

(e) Prohibit such member from taking, directly or indirectly, the other