From:	Jennifer Cespedes <cespedes@dc-energy.com>
Sent:	Monday, April 26, 2010 4:59 PM
To:	secretary <secretary@CFTC.gov>
Cc:	Dean Wilde <wilde@dc-energy.com>
Subject:	Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations
Attach:	2010-04-26_DCE_CFTC_Referenced Energy Contracts.pdf; ATT00002.htm

Jennifer Cespedes, Executive Assistant
DC Energy
Tel: (703) 760-4409 | Fax: (703) 506-3905
cespedes@dc-energy.com

DC Energy

8065 Leesburg Pike, 5th Floor • Vienna, Virginia 22182-2733 • Direct: 703.506.3902 • Fax: 703.506.3905 • wilde@dc-energy.com

Dean L. Wilde, II
MANAGING DIRECTOR &
CHIEF EXECUTIVE OFFICER

April 26, 2010

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

RE: Comments on Proposed Federal Speculative Position Limits on Referenced Energy Contracts

Dear Mr. Stawick:

This letter is submitted as our **"Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations"** with regard to the Commodity Futures Trading Commission ("Commission") January 26, 2010 Notice of Proposed Rulemaking ("NOPR"). DC Energy LLC, ("DC Energy"), hereby provide comments on the NOPR. I am the Managing Director and CEO of DC Energy Holdings, LLC. DC Energy invests in the electricity and gas markets, and provides hedge products and liquidity to physical and financial participants.

The Commission is "proposing to establish reporting market specific Federal speculative position limits for futures and option contracts in certain energy commodities and aggregate position limits that would apply across economically similar contracts, regardless of whether such contracts are listed on a single or on multiple reporting markets, to curb the impact of disruptive excessive speculation."[1]

The Commission further specified that "...the speculative position limits would apply only to referenced energy contracts. Proposed regulation 151.1 defines referenced energy contracts to mean one of four enumerated contracts—the NYMEX Henry Hub natural gas contract, the NYMEX Light Sweet crude oil contract, the NYMEX New York Harbor No. 2 heating oil contract, and the NYMEX New York Harbor gasoline blendstock (RBOB) contract—and in addition, any other contract that is exclusively or partially based on the referenced contracts' commodities and deliverable at locations specified in the proposed regulations. Basis contracts and diversified commodity index futures that are based on such contracts' commodities, however, would not be considered to be referenced energy contracts and,

[1] NOPR at 4149.

therefore, would not be subject to the proposed speculative position limits."[2]

In addition, the Commission has stated "Basis contracts, as defined in proposed regulation 151.1, are futures or option contracts that are cash settled based on the difference in price of the same commodity (or substantially the same commodity) 70 at different delivery points. These basis contracts have been excluded by the Commission from the speculative position limits because they price the difference between the same commodity in two different locations and not the underlying commodity itself."[3]

DC Energy agrees that basis contracts represent a very different exposure and should be handled separately from speculative limits imposed on the commercial hub that acts as a reference point to the basis contract. This will be particularly relevant to power contracts where basis contracts are a critical element of managing locational price risk in the US power markets.

However, we are concern that the action by relevant exchanges, such as The Intercontinental Exchange, the Chicago Merchantile Exchange and the Nodal Exchange to disaggregate power basis trades into its constituent parts may create a confusion in applying the Commission stated exemptions for basis contracts. The exchanges make this segmentation merely because it simplifies the clearing process[4] without consideration as to what this may imply to future speculative limits on one of the constituents of the basis trade. DC Energy is concerned that the action to segment the basis trade into one position on the hub reference and one position on the local power may create unwanted limitations on the liquidity of basis trading in power contracts. The intent of the Commission regarding basis contracts needs to be upheld regardless of the implementation mechanics of the exchanges.

The NOPR states: "Proposed regulation 151.2(b)(1) would establish aggregate all-months-combined and single-month speculative limits for positions held outside the spot month. The proposed framework premises its limits on open interest levels, and would establish speculative position limits aggregately, that is, across contracts of different classes on a single exchange and across all reporting markets listing the same referenced energy contracts.[5] The NOPR continues: "The proposed regulations would establish an all-months-combined aggregate position limit that is fixed by the Commission at 10% of the aggregated open interest value discussed above, up to 25,000 contracts, with a marginal increase of 2.5% thereafter. The proposed regulations would set the single-month aggregate position limit at two-thirds of the position limit fixed for the all-months-combined aggregate position limit. This means that the aggregate all-months-combined position limit level would be 150% of the aggregate single-month position limit level."[6]

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[2] NOPR at 4152.

[3] NOPR at 4153

[4] For instance, the Nodal Exchange clears power contracts at over 1800 separate locations. If each basis combination was cleared as a separately defined contract, it would require over 3,000,000 contracts, an unmanageable number for the exchange to clear.

[5] NOPR at 4153.

[6] NOPR at 4155.

We suggest the decision to apply position limits and the limits themselves need to be based on facts and statistically valid analysis to ensure that they will have the desired effect. We are concerned that political pressure is creating a rush to enact limits without the backing of sound empirical analysis that shows when speculation in the financial markets causes price bias or increases volatility. We have seen a number of studies that show speculation does not create price biases or increase volatility, and have only found anecdotal stories in support of the opposing view, but the anecdotes don't hold up to statistical scrutiny. Given the prevailing empirical assessments, new policies which limit market volumes and financial activity must be carefully vetted to ensure they do not result in more harm than good.

Position limits should be set and reviewed by the Commission for each market with a view to the market size (current and desired), to promote liquidity, and encourage competition. Pricing will be more efficient and hedge products will be cheaper, if there is more competitors and if it possible to transact without undue influence on price (i.e. liquidity). *Larger financial markets enable this outcome*. Consequently, the consumer benefits when the financial market is large relative to the underlying physical market. Unfortunately, there is a lingering myth that a commodity traded financially incurs higher cost because a "middleman" is taking a cut every time a commodity is traded. This is clearly not the case, as a financial trade creates a long and short contract by two parties that is indexed to the price of the commodity – it is not part of the distribution system for the physical commodity. In fact, the opposite is true, and the consumer and economy benefit as more investors compete given their viewpoints on the commodity's future. *If position limits result in smaller less liquid markets they will have failed. Larger liquid markets provide robust price discovery, more competition, and are much more resistant to price manipulation than small illiquid ones.*

The NOPR further states: "As proposed, the intent of the aggregate position limits is to permit for the netting of positions in a referenced energy contract's different classes on a single exchange and across the exchanges for the purpose of determining compliance with the aggregate all-months-combined and aggregate single-month speculative position limits. Accordingly, no trader would be permitted to hold net long or net short referenced energy contract positions that, when combined with net long or net short positions in the same referenced energy contract on another exchange, would exceed the aggregate all-months-combined and aggregate single-month speculative position limits."[7]

We agree position limits should be applied to *aggregate net positions*. The aggregation should net positions across exchanges and bilateral agreements, so that participants would be accountable for their total net position. Without this provision, competition amongst exchanges will be severely harmed as new exchanges will not be able to compete because their independently measured open interests would result in prohibitively low limits for participants. Products that trade in different geographic areas for different prices (e.g. power hubs, natural gas basis) should be aggregated for purposes of netting as well. This is important because consumers and producers of power and energy are local. They produce power or energy at specific, granular locations and consumers buy it at specific locations.

[7] Ibid.

Correspondingly, they would like to hedge their positions at these specific locations because prices can vary from location to location. Financial investors providing hedges need to offer products at these locations and then often obtain some offsetting position at a more liquid hub. These geographic differences should be netted to capture the full economic position, so that a "short" hedge at one location is measured in light of its "long" offsetting position at another location. Failure to perform this geographic netting will limit the availability of locational hedges for both consumers and producers, which will raise the cost of capital for producers and ultimately increase the price paid by the consumer.

With this same logic, we suggest that calendar spreads should also be viewed as net positions within the class, rather than in the gross positions of their constituent parts. In the proposed position limits, "a trader's positions in contracts of the same class in a single month on a reporting market, measured on a gross basis, would be limited to no greater than two times the all-months-combined class position limit fixed for that reporting market."

Thank you for considering our opinion when making your decisions.

Sincerely,