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Submitted Electronically

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

Re: Position Limits for Derivatives,
RIN 3038-AD15 and RIN 3038-AD16

Dear Mr. Stawick:

The American Petroleum Institute ("API") submits these comments in response to the notice of proposed rulemaking ("NOPR") issued by the Commodity Futures Trading Commission (the "Commission" or "CFTC") concerning position limits for derivatives under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[1]

API is a national trade association representing more than 450 oil and natural gas companies. API's members transact in physical and financial, exchange-traded, and over-the-counter markets primarily to hedge or mitigate commercial risks associated with their core business of delivering energy to wholesale and retail consumers. Associated with the hedging of physical exposures, API members enter into swap transactions to offset credit risks and to facilitate physical transactions. API members range from the largest major oil company to the smallest of independents. They are producers, refiners, suppliers, pipeline operators, and marine transporters, as well as service and supply companies that support all segments of the industry. Because API members rely on the integrity of markets under the Commission's jurisdiction, we appreciate the opportunity to comment.

I. Introduction

API supports the Commission's commitment to ensuring the integrity and the efficiency of the derivatives markets on which API members rely to hedge risk. API believes,

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[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010). The proposed rules are set forth in Position Limits for Derivatives, 76 Fed. Reg. 4752 (proposed Jan. 26, 2011) (to be codified at 17 C.F.R. pts. 1, 150 & 151).

however, that a vague, unclear, or needlessly restrictive position limits rule or bona fide hedge exemption will increase costs to market participants, interfere with their ability to hedge risk,[2] disrupt market efficiency,[3] and potentially drive trading to unregulated markets beyond the Commission's jurisdiction.[4] These results are contrary to Dodd-Frank, and they would impair the integrity of derivatives markets and the safety of the United States financial system.

With these concerns in mind, API offers the following suggestions:

- The position limits rule should not chill any activity -- hedging or speculative -- that provides market liquidity and facilitates price discovery.
- The Commission should clarify and simplify the position limits rules to reduce compliance risks for market participants.
- The Commission should clarify the scope of the bona fide hedge exemption.
    - The Commission should preserve the non-enumerated hedge exemption.
    - The Commission should clarify that market participants qualify for the bona fide hedge exemption when they hedge risk on a portfolio basis.
    - The Commission should clarify the requirements for bona fide hedging swap counterparties.
- The Commission should simplify the reporting requirements for the bona fide hedge exemption.
    - The Commission should retain the anticipatory hedge exemption, so that most market participants can conform to their current practice of applying for the bona fide hedge exemption in advance.
    - With respect to non-anticipatory hedging, the Commission should not require daily reports, but instead should require reports when the trader's

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[2] *Contra* Dodd-Frank § 737(a)(4) (CEA § 4a(a)(3)(B)(iii)) (directing Commission "to ensure sufficient market liquidity for bona fide hedgers").

[3] *Contra id.* (CEA § 4a(a)(3)(B)(iv)) (directing Commission "to ensure that the price discovery function of the underlying market is not disrupted").

[4] *Contra id.* (CEA § 4a(a)(2)(C)) (directing Commission to "strive to ensure . . . that any limits to be imposed by the Commission will not cause price discovery in the commodity to shift to trading on the foreign boards of trade").

position exceeds the limit, when its hedging needs increase, and on a monthly basis to assist the Commission's oversight.

- The Commission should state clearly that sensitive commercial information reported pursuant to the bona fide hedge rules will not be disclosed publicly.

- The Commission should clarify the obligations of affiliated entities.
  - Swaps between affiliates should not count toward position limits.
  - Affiliates that deal with each other at arm's length should not be required to aggregate positions.

- To permit the public to provide substantive comments, the Commission should explain in greater detail how it will determine "estimated deliverable supply" and how it will define "reference paired" contracts.
  - The Commission should determine estimated deliverable supply through a transparent process involving public comment.
  - The Commission should exclude swaps that are not required to be cleared from the definition of referenced paired contracts.

- The Commission should reconsider intra-day position limits given the significant additional complexity of the expanded position limits regime.

II. The Position Limits Rules Should Not Chill Any Activity -- Hedging or Speculative -- Required for Liquidity and Price Discovery

API believes that hedging and speculative activity are both essential to fulfilling Congress's goal of "providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair, and financially secure trading facilities."[5] To provide these benefits, derivatives markets depend on speculative activity that provides the depth needed to meet the hedging demands of both consumers and suppliers, as they behave differently at different ends of the price spectrum. Because API members rely on markets with sufficient liquidity to meet their hedging needs, API urges the Commission to avoid imposing rules that would chill beneficial market activity, including speculation.

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[5] CEA § 3(a) (codified at 7 U.S.C. § 5(a)).

As the Commission has observed, "the line between speculation and hedging can at times be difficult to discern."[6] Market participants, including API members, use derivatives in many ways to reduce risks that arise from the potential change in value of assets, liabilities, or services. Producers are typically considered hedgers when they enter into short financial instruments to offset physical positions. But the same producers may also need to optimize physical assets, requiring them to take both long and short positions in the market. Because these transactions are related to risks associated with physical assets, they should be considered hedging, not speculation. We urge the Commission, in setting limits, to account for the multiple uses of derivatives transactions by integrated oil and gas firms.

The Commission's new regulations must not damage market liquidity or efficiency. This is particularly important for well-functioning markets such as the energy markets. The Commodity Exchange Act ("CEA") and Dodd-Frank do not forbid speculation. Instead, they permit the Commission to set position limits and instruct the Commission, "to the maximum extent practicable," to design position limits to "ensure sufficient market liquidity for bona fide hedgers," and to "ensure that the price discovery function of the underlying market is not disrupted."[7] These provisions demonstrate that Congress "recognize[d] that in setting [position] limits, regulators must balance the needs of market participants, while at the same time ensuring that our markets remain liquid so as to afford end-users and producers of commodities the ability to hedge their commercial risk."[8] Thus, in setting position limits, the Commission should not focus exclusively, or even predominantly, on hypothetical market volatility. Rather, API urges the Commission to exercise caution in setting limits on well-functioning markets and to account for the real market benefits that speculators provide.

Of course, Congress has permitted the Commission to address "unreasonable fluctuations" or "unwarranted changes" in commodity prices.[9] The need for efficient and accurate price discovery can be met, however, by increasing transparency and efficiency in commodity markets. Buyers and sellers with sufficient information about the price of commodities will make informed decisions to manage their business risks. Accordingly, API

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[6] End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80,747, 80,753 (proposed Dec. 23, 2010) (to be codified at 17 C.F.R. pt. 39).

[7] Dodd-Frank § 737(a)(4) (CEA § 4a(a)(3)(B)(iii)-(iv)).

[8] 156 Cong. Rec. S5919 (daily ed. July 15, 2010) (statement of Sen. Lincoln) ("Along these lines I do believe that there is a legitimate role to be played by market participants that are willing to enter into futures positions opposite a commercial end-user or producer. Through this process the markets gain additional liquidity and accurate price discovery can be found for end-users and producers of commodities.").

[9] CEA § 4a(a) (codified at 7 U.S.C. § 6a(a)).

believes that the Commission's separate efforts to increase market transparency will, in large part, avoid "unreasonable" or "unwarranted" changes in prices.[10]

III. Market Participants Need Simpler, Clearer Rules

API is concerned that the proposed position limits rules are unnecessarily complex and unclear in important respects. Market participants need clearer guidance about how to comply with the new position limits rules. Not only does the Commission currently lack sufficient data to set limits, but the proposed rules, which rely on vague concepts such as "estimated deliverable supply" and "reference paired contracts," provide little guidance to market participants. The same is true for the bona fide hedge exemption on which market participants rely to reduce risks attending the operation of their businesses. This uncertainty creates compliance risks and increases costs for market participants, including API members.

The Commission's proposed rules will also require market participants to transform their operations to comply with a significantly expanded position limits regime. In addition to clearer guidance, API respectfully requests that the CFTC take into consideration the significant period of time market participants will need to bring themselves into compliance with the new regime.

In light of these concerns, API requests that the Commission make the following clarifications.

A. The Commission Should Clarify the Scope of the Bona Fide Hedge Exemption

1. The Commission Should Preserve the Exemption for Non-Enumerated Hedging Transactions

Market participants, including API members, rely on the ability to apply for bona fide hedge treatment of non-enumerated hedge transactions.[11] As the Commission recognized in 1977, when it proposed the bona fide hedge exemption, the list of enumerated hedging transactions "may not include all of the specific types of transactions and positions which the Commission would consider as conforming to its definition of bona fide hedging."[12] Without

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[10] In this regard, others have observed, and API agrees, that the CEA does not permit the Commission to set position limits unless "the Commission finds" that they "are necessary to diminish, eliminate, or prevent" the burdens of excessive speculation. CEA § 4a(a) (codified at 7 U.S.C. § 6a(a)). API believes that the Commission has not made a sufficient finding to support its authority to prescribe position limits at this time.

[11] *See* 17 C.F.R. § 1.3(z)(3).

[12] Bona Fide Hedging Transactions or Positions, 42 Fed. Reg. 14,832, 14,834 (proposed Mar. 16, 1977) (to be codified at 17 C.F.R. pt. 1) [hereinafter "Bona Fide Hedging"].

significant explanation, however, the proposed rules eliminate the non-enumerated hedge provisions on which market participants currently rely.[13] API members currently engage in bona fide hedge transactions that do not fit within the list of enumerated transactions. The catch-all non-enumerated hedging provision is necessary to accommodate the evolving hedging needs of commercial energy firms. Absent its inclusion, API fears that its members' bona fide hedging may be restricted if it does not fit within the enumerated list. API therefore urges the Commission to reconsider its decision to limit the scope of the bona fide hedge exemption to only the enumerated list of hedge transactions.

Dodd-Frank directs the Commission to define a bona fide hedging transaction more broadly than the list of enumerated hedging transactions listed by the Commission, based on the same general considerations that the Commission currently employs.[14] Indeed, Dodd-Frank does not reference the Commission's enumerated hedging transactions. Rather, Congress included the same general considerations currently contained in 17 C.F.R. § 1.3(z). Nothing in Dodd-Frank or the legislative history supports restricting the scope of the bona fide hedge exemption by removing the non-enumerated hedge provisions that the Commission designed to permit market participants to take advantage of the full scope of the bona fide hedge exemption. API therefore urges the Commission to preserve the procedure for applying to the Commission for bona fide hedge exemptions for non-enumerated transactions or positions under § 1.3(z)(3).

2. The Commission Should Clarify that the Bona Fide Hedge Exemption Covers Portfolio Hedging

API urges the Commission to reiterate that the definition of bona fide hedging covers portfolio hedging. Because some API members are involved in multiple segments of the oil and gas industry, they may be exposed to risks associated with the potential change in the value of commodities they both buy and sell. Rather than hedge the risk of each particular asset, liability, service, or transaction separately, API members, like most commercial market participants, prefer to manage risk on a portfolio basis.

Dodd-Frank and the proposed rules define a bona fide hedge as a transaction or position in a referenced contract that, among other things:

> (ii) is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise; and

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[13] *See* NOPR, 76 Fed. Reg. at 4763 (indicating that "the Commission is removing the procedure to apply to the Commission for *bona fide* hedge exemptions for non-enumerated transactions or positions under § 1.3(z)(3)").

[14] *See* Dodd-Frank § 737(c)(2) (CEA § 4a(c)(2)). API agrees with the Commission that this definition of bona fide hedging should apply to swaps as well as to futures and options. *See* NOPR, 76 Fed. Reg. at 4760.

(iii) arises from the potential change in the value of --

(I) assets that a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;

(II) liabilities that a person owns or anticipates incurring; or

(III) services that a person provides, purchases, or anticipates providing or purchasing . . . .[15]

API believes that this broad language, which is not limited to one-to-one hedges, permits portfolio hedging.

Indeed, this language has its origins in the definition of bona fide hedging proposed by the CFTC in 1977. That definition replaced language requiring "offsetting positions in the same commodity" with a more flexible standard that "describes risks arising from changes in the value of assets, liabilities, or services attendant to the operation of a commercial business."[16] This change was needed because "the Commission understands that many business firms calculate their price risk exposure, less on the basis of risk related to a single transaction and more on the basis of net risk related to changes in the values reflected on balance sheets."[17] In choosing substantially the same language that the Commission originally proposed for this

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[15] *See* Dodd-Frank § 737(c)(2) (CEA § 4a(c)(2)); *accord* NOPR, 76 Fed. Reg. at 4771 (proposed 17 C.F.R. § 151.5).

[16] Bona Fide Hedging, 42 Fed. Reg. at 14,883. The proposed definition, which was to be codified at 17 C.F.R. § 1.3(z)(1), stated:

> Bona fide hedging transactions and positions shall mean transactions or positions in a contract for future delivery on any contract market, where such transactions or positions represent a substitute for transactions to be made or positions to be taken at a later time in a physical marketing channel, and where they are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, and where they arise from:
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> (i) The potential change in the value of assets which a person owns, produces, manufacturers, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising.
>
> (ii) The potential change in the value of liabilities which a persons owes or anticipates incurring, or
>
> (iii) The potential change in the value of services which a person provides, purchases or anticipates providing or purchasing.

Id. at 14,836.

[17] *Id.* at 14,883.

purpose, Congress surely intended to preserve the ability of market participants to hedge risk on a portfolio basis.

To the extent Dodd-Frank narrows the current definition of bona fide hedging, it specifies that the exemption to certain position limits applies to a hedge that "represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel."[18] API does not read the Dodd-Frank statutory language to allow the bona fide hedge exemption to apply only to cash-market transactions that hedge risk on a one-to-one basis. Accordingly, API urges the Commission to clarify and reiterate that the bona fide hedge exemption will continue to be available to commercial market participants that hedge risk on a portfolio basis.

3. The Commission Should Clarify the Requirements for Bona Fide Hedging Swap Counterparties

Dodd-Frank directs the Commission to define bona fide hedging to include a transaction or position that "reduces risks attendant to a position resulting from a swap that . . . was executed opposite a counterparty for which the transaction would qualify as a bona fide hedging transaction."[19] In implementing this direction, the Commission has proposed requirements for bona fide hedging swap counterparties. Specifically, the proposed rules require counterparties, among other things, to ask for a written representation verifying that the swap qualifies as bona fide hedging and confirm receipt of that representation.[20] API is concerned that, in practice, this rule will be unworkable. Depending on what sort of written representation is required, this requirement could significantly delay the process of entering into a swap and frustrate separate obligations for real-time reporting and calculation of positions. API therefore requests that the Commission clarify that electronic representations consistent with standard business practice will satisfy this requirement. API further requests that the Commission clarify that good faith, reasonable reliance on a written representation that the transaction qualifies as a bona fide hedge will discharge a counterparty's duty under this section. The Commission should clarify that, if it later determines that a transaction did not qualify as a bona fide hedge, it will not impose penalties on an entity that, in good faith, relied on its counterparty's written representations.

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[18] *See* Dodd-Frank § 737(c)(2) (CEA § 4a(c)(2)(A)(i)).

[19] *Id.* (CEA § 4a(c)(2)(B)).

[20] *See* NOPR, 76 Fed. Reg. at 4773 (proposed 17 C.F.R. § 151.5(g)(1)).

B. The Commission Should Simplify Reporting Requirements

1. The Commission Should Preserve the Anticipatory Hedge Exemption

Because bona fide hedge reporting should serve the Commission's oversight needs without interfering excessively with the normal business operations of market participants, API supports the Commission's decision to apply the current anticipatory hedge exemption framework of 17 C.F.R. § 1.48 to its new position limits regime.[21] Currently, many API members apply for hedge exemptions in advance based on their expected hedging needs for the coming year. If their hedging needs change, they apply in advance for a particular delivery month. These filings are made annually, not every day. API understands the anticipatory hedge exemption proposed by the Commission to be consistent with this practice. Accordingly, API supports that part of proposed § 151.10(b) that states that a daily 9 a.m. filing is not required if a 404A filing is made pursuant to the anticipatory hedge exemption.[22]

Anticipatory hedging benefits both market participants and the Commission's oversight. More frequent reporting would impose significant costs on market participants. For example, daily reporting requirements create uncertainty for market participants about how the Commission will respond to their applications for bona fide hedge treatment. In addition to providing certainty to market participants, the anticipatory hedge framework benefits the Commission's oversight. The Commission will require tremendous resources to review daily filings of bona fide hedging. A single annual filing of anticipated needs will facilitate the Commission's oversight without this burden.

Further, given that market participants are familiar with the exchange process for granting hedge exemptions to position limits, API urges the Commission to involve exchanges as much as possible in the bona fide hedge exemption process. Modeling the new hedge exemption process as closely as possible to the existing exchange-managed process will ease the burden on participants to transition to the new process and will conserve CFTC resources. To be sure, the new rules will implement limits across exchanges, and no one exchange may be in a position to oversee all positions. But API believes that relying as much as possible on the exchanges will ease the burden of complying with the new position limits regime.

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[21] *See id.* (stating that proposed 17 C.F.R. § 151.5(c) "incorporat[es] the current requirements of Commission § 1.48").

[22] *See id.* at 4775.

2. To the Extent a Market Participant Does Not Apply for a Bona Fide Hedge Exemption in Advance, the Commission Should Not Require Daily Reporting

API understands that the Commission needs information to verify that market participants exceeding limits are, in fact, engaged in bona fide hedging.[23] To the extent, however, that market participants will claim a bona fide hedge exemption without applying for it in advance, API does not believe that daily filing is appropriate. Rather, API urges the Commission to adopt its proposed alternative, which would "only require reports to be submitted either when a trader's position either first exceeds a limit or when a trader's hedging need increases, with a monthly summary while the trader's position remains in excess of the limit."[24]

Daily reporting would be burdensome for market participants and would not provide significant additional information to the Commission. The Commission's proposed alternative solves this problem by providing the Commission with information about material changes in the hedger's position and a monthly summary, without a 9 a.m. daily reporting requirement. This would lower compliance costs without compromising the Commission's important oversight responsibility. Accordingly, API urges the Commission to maintain the current process for approval of anticipatory hedging needs and to require reports only when the hedger's position exceeds the limit and when the trader's hedging need increases thereafter, with a monthly positions summary.

3. The Commission's Reporting Rules Should Not Risk Public Disclosure of Sensitive Commercial Information

Traders that claim a bona fide hedge exemption to position limits will be required to report sensitive commercial information about, among other things, their cash market positions, the number of contracts they use for hedging, and the quantities of cash market commodities being held.[25] The NOPR does not say how much, if any, of this information will be publicly available through requests under the Freedom of Information Act ("FOIA") or otherwise. Given the sensitive and confidential nature of this information, API asks the Commission to clarify that it will not disclose information provided pursuant to the position limits rules. The CEA states that "the Commission may not publish data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers,"[26] and the Commission's FOIA regulations permit market

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[23] *See id.* at 4761 (noting that "reports would support hedgers' need for large referenced contract positions and would give the Commission the ability to verify the positions were a *bona fide* hedge").

[24] *Id.*

[25] *See id.* at 4772 (proposed 17 C.F.R. § 151.5(b)).

[26] *See* CEA § 8(a)(1) (codified at 7 U.S.C. § 12(a)(1)).

participants to apply for confidential treatment of certain information.[27] API urges the Commission to state clearly that information provided in connection with bona fide hedge filings will not be made publicly available.

C. The Commission Should Clarify the Obligations of Affiliated Entities

1. Swaps Between Affiliates Should Not Count Toward Position Limits

API urges the Commission to clarify that swaps between affiliates do not count toward position limits. The proposed rules generally aggregate the positions of affiliated entities,[28] and generally apply to net long or net short positions.[29] Because a swap between affiliates would have no net effect on the aggregate positions of affiliated entities, the final rule should make clear that the Commission will not consider such swaps for purposes of position limits. This approach is consistent with the Commission's treatment of inter-affiliate swaps in other contexts. For example, in proposing rules further defining "swap dealer," the Commission said, "we preliminarily believe it would be appropriate for the person to consider the economic reality of any swaps and security-based swaps it enters into with affiliates (*i.e.*, legal persons under common control with the person at issue), including whether those swaps and security-based swaps simply represent an allocation of risk within a corporate group."[30] The Commission should take the same approach here. API therefore urges the Commission to clarify that inter-affiliate swaps will not count toward position limits.

2. The Final Rules Should Not Aggregate Positions of Affiliates that Transact at Arm's Length in the Market

To comply with the Commission's proposed position aggregation requirements, affiliates will have to exchange sensitive commercial information with one another. In certain cases -- for example, for joint ventures -- sharing information necessary to comply with the aggregation rules will violate other laws, including antitrust laws. Dodd-Frank does not alter API members' obligation to comply with antitrust laws,[31] and the final rules should not put

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[27] *See* 17 C.F.R. § 145.9.

[28] *See* NOPR, 76 Fed. Reg. at 4774 (proposed 17 C.F.R. § 151.7).

[29] *See id.* at 4770 (proposed 17 C.F.R. § 151.4(a)) (setting spot-month limits on "positions . . . net long or net short" in (1) contracts for physical delivery, and (2) cash-settled contracts); *id.* at 4771 (proposed 17 C.F.R. § 151.4(f)(2)-(3)) (setting forth netting rules for non-spot-month position limits).

[30] *See* Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 Fed. Reg. 80,174, 80,183 (proposed Dec. 21, 2010) (to be codified at 17 C.F.R. § 1 & 240).

[31] Dodd-Frank § 6 ("Nothing in this Act, or any amendment made by this Act, shall be construed to modify, impair, or supersede the operation of any of the antitrust laws, unless otherwise specified.").

market participants in the impossible position of having to comply with two inconsistent sets of law.

To this end, API supports the Commission's proposal to implement an exemption to aggregation of affiliate positions for owned non-financial entities that are independently controlled and managed.[32] Given the need for market participants, including API members, to comply with different laws, API urges the Commission to make two clarifications. First, the Commission should clarify that once an application is filed, independently controlled and managed affiliates will be entitled to the exemption pending the Commission's review. Second, the Commission should clarify that an "independent assessment report" conducted by either an independent internal audit group or by an external service provider will satisfy the requirement of proposed § 151.7(g)(ii).[33] API believes that these clarifications would ease the burden of inconsistent regulation on market participants while preserving the Commission's ability to ensure that position limits are not evaded by affiliates that do not, in fact, deal at arm's length.

D. The Commission Should Provide Clearer, More Transparent Definitions

1. The Commission Should Determine "Estimated Deliverable Supply" In a Transparent Manner that Allows for Public Input

API finds it difficult to comment on the proposed spot-month position limits because the Commission has not explained how it proposes to determine "estimated deliverable supply." Exchange estimates of deliverable supply currently lack transparency. We believe, however, that the need for transparency is even greater in the second phase of position limits implementation, when the Commission "could choose to adopt exchange-provided estimates or, for example, in the case of inconsistent estimates from exchanges, issue its own estimates."[34] API urges the Commission, in adopting its own estimates of deliverable supply, not only to explain to market participants how it will calculate deliverable supply, but also to invite their comments on issues that should inform the Commission's determination. API believes that all data needed to calculate estimated deliverable supply, including data about production, storage, and alternative delivery options, should be publicly available. The Commission should then provide a period during which interested parties could submit written comments that will inform the Commission's final estimates. Because market participants are in the best position to advise the Commission about factors that should inform its estimates, it is critically important that they have a voice in the process. In order to manage risk appropriately, oil and gas companies

[32] *See* NOPR, 76 Fed. Reg. at 4774 (proposed 17 C.F.R. § 151.7(f)).

[33] *Id.* API notes that there is no proposed § 151.9(f). For purposes of these comments, API assumes that the reference to § 151.9(f)(3) in this paragraph refers instead to § 151.7(f)(3).

[34] NOPR, 76 Fed. Reg. at 4757.

constantly evaluate the supply of various commodities and potential constraints on supply. In the end, an open, transparent process for estimating deliverable supply will increase the transparency and integrity of the market.

API supports the many efforts to increase transparency and thereby to increase market efficiency in the energy markets. Improvements to the price index reporting process and index price formation process over the last few years have improved transparency and efficiency to the benefit of all market users and energy consumers. The underlying function of the futures and derivatives markets -- to provide the opportunity to offset price risk -- is best served with wide availability of price information. Regulators also benefit from the increased price transparency in the index price reporting process. API asks the regulators to continue to ensure there is sufficient information available for buyers and sellers to make informed decisions about managing risk, and to enable them to determine the supply of underlying deliverable commodities

2. The Commission Should Clarify the Definition of a "Referenced Paired" Contract

API is concerned that the definition of "referenced contract," which includes "referenced paired" contracts, is ambiguous. In particular, API is concerned that individual market participants could interpret the definition differently for the same contract. For example, absent guidance from the Commission, market participants will likely be unable to determine with sufficient precision whether a delivery location has "substantially the same supply and demand fundamentals[] as that of any core referenced futures contract."[35] Especially as applied to energy transactions, individual market participants may reach different conclusions about which contracts have substantially the same supply and demand fundamentals. The current rule suggests that individual market participants will bear the burden of making this determination. API believes that, to avoid making inconsistent determinations, market participants require greater clarity from the Commission about the definition of a "referenced paired" contract.

To solve this problem, API proposes that the Commission clarify that swaps that are not required to be cleared will not be considered referenced paired contracts. Dodd-Frank requires the Commission to determine which swaps should be required to be cleared.[36] Bespoke swaps without significant liquidity or adequate pricing data will likely not be required to be cleared or accepted for clearing by a derivatives clearing organization. For these swaps, API believes that the costs of imposing position limits outweigh the benefits. To the extent position limits are designed to address sudden or unreasonable fluctuations or unwarranted changes in commodity prices, those concerns do not apply with equal force to bespoke swaps. Accordingly,

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[35] *Id.* at 4768 (proposed 17 C.F.R. § 151.1).

[36] *See* Dodd-Frank § 723(a)(3) (CEA § 2(h)(2)).

the Commission should clarify that swaps not required to be cleared will not be deemed to be referenced paired contracts.

E. The Commission Should Reconsider Its Decision to Set Intra-day Position Limits as It Implements a New Position Limits Regime

API appreciates that, currently, "position limits apply on an intraday as well as an end-of-day basis."[37] Because the proposed rules expand position limits to apply to swaps and to aggregate positions across exchanges, API believes the Commission should reconsider the costs, benefits, and feasibility of requiring market participants to calculate their positions on an intra-day, as well as on an end-of-day, basis. API believes that intra-day position limits would be unnecessarily complex and present compliance challenges in a fast-moving trading environment. Furthermore, intra-day limits are unlikely to provide a significant benefit to the market in addition to end-of-day limits. The Commission should consider the costs and difficulty of complying with intra-day limits in the context of the significantly expanded proposed position limits regime. API therefore urges the Commission to engage in a rigorous analysis of the regulatory burdens of intra-day limits and ultimately clarify that position limits will only apply at the end of each trading day.

IV. Conclusion

For the reasons described in these comments, API is concerned that the proposed position limits rules are too vague and complex, and that they risk impairing market liquidity and price discovery. In implementing final rules setting position limits, the Commission should avoid chilling beneficial speculative activity that provides the liquidity on which market participants, including API members, rely to hedge risk. The final rules should also clarify that the bona fide hedge exemption will, as Dodd-Frank's language suggests, encompass non-enumerated hedging and portfolio hedging, and that reporting requirements will be no more onerous than necessary for the Commission to fulfill its oversight role.

API appreciates the opportunity to provide these comments. We would be pleased to provide additional information regarding our views on the proposed rule, and would welcome the opportunity to work with the Commission. Please contact me or Brian Knapp at (202) 682-8172 if you have any questions.

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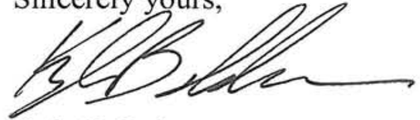
[37] Commodity Futures Trading Commission, Division of Market Oversight, Advisory Regarding Speculative Position Limits 2 (May 7, 2010), *available at* http://www.cftc.gov/ucm/groups/public/@industryoversight/documents/file/specpositionlimitsadvisory0510.pdf.

Sincerely yours,



Kyle B. Isakower
Vice President
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cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott D. O'Malia, Commissioner