BRACEWELL
&GIULIANI

Texas
New York
Washington, DC
Connecticut
Seattle
Dubai
London

David M. Perlman
Partner

202.828.5804 Office
202.857.4842 Fax

david.perlman@bgllp.com

Bracewell & Giuliani LLP
2000 K Street NW
Suite 500
Washington, DC
20006-1872

March 28, 2011

Via Online Submission

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

Re: COMMENTS OF THE COALITION OF PHYSICAL ENERGY COMPANIES – Position Limits for Derivatives - **RIN Nos. 3038-AD15, 3038-AD16**

Dear Mr. Stawick:

On January 26, 2011, the Commodity Futures Trading Commission ("CFTC" or the "Commission") published a notice of proposed rulemaking entitled "Position Limits For Derivatives."[1] The Position Limits NOPR proposes to establish position limits for "economically equivalent derivatives" consisting of futures, options, and swaps relating to specified referenced contracts.[2] The position limits will consist of (1) aggregate position limits for spot months; and (2) aggregate, futures class, and swaps class position limits for single month and all months combined positions.[3] The proposed position limits will be in addition to current exchanged-based limits.

Prior to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act,[4] the Commission had proposed federal position limits for certain commodity futures and options.[5]

---

[1] Position Limits for Derivatives, 76 Fed. Reg. 4752 (Jan. 26, 2011) ("Position Limits NOPR" or "NOPR").

[2] *Id.* at 4753.

[3] *Id.* at 4752.

[4] Public Law No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank").

[5] Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 4144 (Jan. 26, 2010) ("2010 Proposal").

Subsequent to Dodd-Frank's enactment, the Commission withdrew that rulemaking[6] and, in accordance with Section 737 of Dodd-Frank, proposed the Position Limits NOPR.

The Coalition Of Physical Energy Companies ("COPE")[7] hereby provides comments on the Position Limits NOPR. The members of COPE are physical energy companies in the business of producing, processing, and merchandizing energy commodities at retail and wholesale. COPE members utilize swaps and futures to hedge the commercial risk of their physical businesses. COPE believes that: (1) there is no predicate for finding federal position limits to be appropriate at this time; and (2) the Position Limits NOPR is overly complex and creates significant and burdensome requirements on end-users. Accordingly, the Commission should decline to issue a rule based on the Position Limits NOPR.

Dodd-Frank Does Not Mandate That the Commission Promulgate a Position Limits Rule

Section 737(a) of Dodd-Frank states:

> "(A) IN GENERAL.—In accordance with the standards set forth in paragraph (1) of this subsection and consistent with the good faith exception cited in subsection (b)(2), with respect to physical commodities other than excluded commodities as defined by the Commission, the Commission shall by rule, regulation, or order establish limits on the amount of positions*, **as appropriate***, other than bona fide hedge positions, that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a designated contract market.
>
> "(B) TIMING.—
>
> "(i) EXEMPT COMMODITIES.[8]—For exempt commodities, the limits required under subparagraph (A) shall be established within 180 days after the date of the enactment of this paragraph."[9]

Thus, the Commission is required by Dodd-Frank only to establish position limits "as appropriate." The deadline of 180 days after enactment in clause (B)(i) is only triggered upon a determination that such limits are appropriate. Congress unambiguously modified the word "shall" with the requirement that limits only be established "as appropriate." Dodd-Frank is

---

[6] Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, 75 Fed. Reg. 50950 (Aug. 18, 2010).

[7] The members of the Coalition of Physical Energy Companies are: Apache Corporation; El Paso Corporation; Iberdrola Renewables, Inc.; MarkWest Energy Partners, L.P.; Noble Energy, Inc.; Shell Energy North America (US), L.P.; and SouthStar Energy Services LLC.

[8] Energy commodities generally fall within the Commodity Exchange Act ("CEA") definition of "Exempt Commodities." *See* 7 U.S.C. § 1a(14) (2011).

[9] Dodd-Frank § 737(a)(4) (as codified at 7 U.S.C. § 6a(a)(2)) (emphasis added).

replete with "shall" directives to the Commission.[10] Unlike Section 737, the statute's provisions are not typically limited by an "as appropriate" standard. If position limits were an absolute mandate, the words "as appropriate" would be superfluous. It is a maxim of statutory interpretation that the words of a statute should be given a construction that assumes they were chosen to provide meaning and substance.[11]

Given that the Commission has the discretion to determine whether position limits are appropriate, it should consider whether there is any empirical evidence that "excessive speculation" has created an "undue and unnecessary burden on interstate commerce."[12] If the Commission affirmatively determines it has, it should assure that the proposed rule would mitigate such a burden, as well as "not cause price discovery to shift to trading on foreign boards of trade."[13]

There Is No Empirical Support for Position Limits

In the NOPR, the Commission provides no empirical basis to conclude excessive speculation has burdened or harmed modern markets in any way. To the degree the Commission has referenced any real-world examples, they either date from the 1920s or the 1970s and do not relate to speculation.[14] The Commission has chosen to ignore its own recent studies that conclude there is no link between speculation and market issues.[15] In addition, rather than address speculation, the NOPR solely concerns itself with concentration. Speculation, excessive or otherwise, can occur in the absence of concentration. The NOPR in no way recognizes or addresses this fact.

In the wake of recent energy and agricultural commodity price volatility, the CFTC, together with other expert agencies, investigated the associated impact of speculation. They concluded:

> If a group of market participants has systematically driven prices, detailed daily position data should show that that group's position changes preceded price changes. The Task Force's preliminary analysis, based on the evidence available to date, suggests that changes in futures market participation by speculators have

---

[10] *See*, *e.g.*, Dodd-Frank § 723(a)(3) (as codified at 7 U.S.C. § 2(h)(2)(A)(i)) ("The Commission on an ongoing basis shall review each swap . . . to make a determination as to whether the swap . . . should be required to be cleared."); *id.* (as codified at 7 U.S.C. § 2(h)(5)) ("Rules adopted by the Commission under this section shall provide for the reporting of data . . . ."); *id.* at § 729 (as codified at 7 U.S.C. § 6o-1(a)(2)(B) ("The Commission shall promulgate an interim final rule within 90 days of the date of enactment of this section providing for the reporting of each swap entered into before the date of enactment . . . .").

[11] *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (one must give effect to each word in a statute so that none is rendered superfluous).

[12] NOPR at 4754, citing 7 U.S.C. 6a(a)(1).

[13] Dodd-Frank at § 737(a)(4) (as codified at 7 U.S.C. § 6a(a)(2)(C)).

[14] *See* NOPR at 4754.

[15] Interagency Task Force on Commodity Markets, Interim Report on Crude Oil, p. 3 (July 2008).

> not systematically preceded price changes. On the contrary, most speculative traders typically alter their positions following price changes, suggesting that they are responding to new information – just as one would expect in an efficiently operating market.[16]

The Commission does not have to base its rule on the results of this recent study. However, the Commission should acknowledge this work and explain or refute it prior to implementing any rule designed to prevent excessive speculation. Simply stated, to find the proposed position limits to be appropriate, the Commission should rely on recent empirical data. Given its recent published findings, the need for contrary data should be self-evident.

Further, beyond special call data collected from time to time, the Commission has extremely limited data concerning over-the-counter ("OTC") swap markets. It will not be until Dodd-Frank is "up and running" that the CFTC will be able to fully consider the scope and dynamics of such markets. Given this information vacuum, it is ill-advised to subject any OTC swaps to position limits until there is data upon which to judge their propriety.

Importantly, if the Commission is concerned about speculation, it should address that topic rather than merely focus on concentration. In the period between mid-2007 and the third quarter of 2008, investors concerned about equity and bond market valuations (as well as currencies) were looking for another "asset class" in which to invest. Many investors took the view that global market dynamics, driven by developing economies such as China and India, would push up commodity prices as demand for energy and agricultural products increased. As such, they looked to invest in the "commodity asset class." This group of investors (such as pension funds, money mangers, hedge funds, individuals, and others) did not typically hold large individual concentrations. They did, however, collectively and speculatively invest directionally the same in a significant way by "going long commodities." Without expressing an opinion as to whether this speculative investment was "excessive," it did not necessarily involve individual traders holding large concentrations. The proposed rule does not address these facts or similar speculative investments in any way.

Given the material burden and questionable value of the proposed rule, COPE requests that the Commission either demonstrate an empirical tie between the proposed rule and the elimination of an identifiable "burden on interstate commerce" or find it is not appropriate to issue a position limits rule at this time.[17]

---

[16] *Id.* This conclusion was re-affirmed in the unpublished final report.

[17] *See, e.g., Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 843-44 (D.C. Cir. 2006) (overturning an agency rulemaking because it was not based on sufficient evidence to justify the new rules and noting that "professing that an order ameliorates a real industry problem but then citing no evidence demonstrating that there is in fact an industry problem is not" the reasoned decision making required of an agency).

The Position Limits NOPR Will Create a Significant Compliance Burden on Market Participants

Under current exchange-based position limits, traders must track their single exchange positions in the spot period as well as understand their positions *vis a vis* accountability levels. As proposed in the Position Limits NOPR, traders will now also have to track their aggregate positions on all exchanges as well as OTC "economically equivalent" swaps. These positions must be tracked initially for the spot month and, ultimately, for each month and all months by class and in aggregate. The increase in complexity of moving from single exchange tracking only to the levels proposed in the NOPR is exponential.

Currently, traders can track the discrete positions held by their firm on a single exchange (particularly in the spot period) and ensure that they do not exceed position limits. This requires a monthly focus for the monthly seventy-two hour period in which the current position limits attach. Under the NOPR, in addition to the current tracking process, traders will need to: 1) determine whether each OTC swap is affected by the limits and convert affected swaps to futures equivalents; 2) track the resulting data and combine those positions with exchange-traded swaps futures and options; 3) separate swaps and futures/options; and 4) do all of the above for the spot month, single month, and all months. Further, as position limits apply in real-time, traders will need to perform the foregoing on a real-time basis.

The complexity of this process is compounded by the increase in scope of the product mix to be covered under the NOPR. A firm may have several traders involved in the totality of the products covered by the NOPR. Thus, currently, there may be discrete traders trading futures and others trading swaps which can be tracked separately if need be. As proposed in the NOPR, all traders and positions are lumped together and a real-time compliance requirement is created spanning the entirety of the firm's book of "economically equivalent" products. Current compliance information, technology, and human resources cannot conduct the requisite monitoring needed to comply with the NOPR. The increased expense to do so will be material. Further, as opposed to the current ability of exchange compliance to track a trader's positions *vis a vis* position limits, it appears no regulator will be tracking compliance with aggregate limits.

Given the unproven value of the position limits proposed in the NOPR and the material cost and complexity of compliance, COPE recommends that the Commission not issue a position limits rule at this time. General compliance costs associated with Dodd-Frank will already be significant. The imposition of the additional significant costs and required attention to be devoted to the Position Limits NOPR will cause overall Dodd-Frank compliance to suffer.

It Is Unclear Which OTC Swaps Are Included in the Proposed Position Limits

The NOPR proposes that "Referenced Contracts" are to be subject to position limits.[18] The proposed definition is:

> *Referenced contract* means, on a futures equivalent basis with respect to a particular core referenced futures contract, a futures listed in § 151.2, or a referenced paired futures contract, option contract, swap or swaption, other than a basis contract or contract on a commodity index.
>
> *Referenced paired futures contract, option contract, swap or swaption* means, respectively, an open futures contract, option contract, swap or swaption that is:
>
> (1) Directly or indirectly linked, including being partially or fully settled on, or priced at a differential to, the price of any core referenced futures contract; or
>
> (2) Directly or indirectly linked, including being partially or fully settled on, or priced at a differential to, the price of the same commodity for delivery at the same location, or at locations with substantially the same supply and demand fundamentals, as that of any core referenced futures contract.[19]

OTC swaps can take many forms. Inclusive of those forms are structures that range from mimicking a core referenced futures contract to being indirectly linked to such a contract. The economic substance of the mimic contract (a "look alike") and a contract with an indirect link (potentially coupled with other floating elements) could and likely would be materially different. As proposed, it appears that the Commission is planning to subject any and all contracts that reference the core referenced contract in any way, regardless of economic substance, to a single position limit. Further, the Commission is also proposing to include all contracts with "the same supply and demand fundamentals, as that of any core referenced futures contract" to the limits for such contract.

Putting aside the question of whether position limits have merit, to be reasonably implemented they should subject a *particular economically equivalent contract* (or "look alike") to a limit. There is simply no justification to expand such limits to contracts with an attenuated connections to the particular referenced contract or those "with substantially the same supply and demand fundamentals." The Commission should restrict any limits it produces to "look alikes." Any other approach will include contracts that are not the economic equivalent of the core referenced contract. Further, ambiguous measures will only lead to uncertainty regarding which OTC swaps are affected. For example, what does "substantially the same supply and demand fundamentals" mean in this context and how can a trader determine if its swap is covered? When does an indirectly linked swap cease to be covered (if ever), and how does a trader make that determination?

---

[18] NOPR at 4753.

[19] *Id.* at 4768.

Further, the Commission has added to the confusion by stating the following:

> Federal spot-month limits would apply only to futures, options and swaps that are directly price-linked to a 151.2-listed core referenced contract or that settle to a price series that prices the same commodity at the same delivery location.[20]

Therefore, for the spot month limits, traders will need to track a different set of contracts. While this is a tighter definition, it is still unclear as to whether referenced contracts in this context are limited to look alikes. In addition, the above-referenced language is not found in the regulatory text proposed by the Commission. Unless it is included in the actual regulation, such preamble language will be meaningless as it contradicts the regulatory text.[21]

The Position Limits Proposal Contains a Number of Practical Issues

While COPE does not believe the Commission should promulgate a final position limits rule, the Commission should remedy the multiple issues raised by the NOPR if it does.

The Rule Requires a "Risk Management Exemption" or Similar Provision

In the 2010 Proposal, the Commission included a "Risk Management Exemption" to position limits so that a swap dealer that was hedging financially-driven risk could exceed limits if justified.[22] The Position Limits NOPR contains no such exemption. Rather, the Position Limits NOPR has a "look through" provision that permits a swap dealer to take advantage of a hedge derivatively only to hedge swaps which are subject to a counterparty's *bona fide* hedge exemption.[23]

As a swap dealer may likely exceed position limits merely by providing hedges to counterparties that do not require a *bona fide* hedge exemption, the Commission should modify its proposal to permit swap dealers to exceed position limits by entering into swaps that are being used by their counterparties to mitigate or hedge commercial risk regardless of whether or not the counterparty is relying upon a hedge exemption. The lack of recognition of the need for swap dealers to be able to hedge this risk without being limited by position limits shows that the proposed rule is flawed. If the Commission does not expand the level of exemption for swap dealers so that they can exceed the limits when providing hedges, end-users may not be able to hedge their commercial risk for want of a counterparty.

---

[20] *Id.* at 4757.

[21] *See Nat'l Wildlife Fed'n v. E.P.A.*, 286 F.3d 554, 570 (D.C. Cir. 2002), *supplemented sub nom. In re Kagan*, 351 F.3d 1157 (D.C. Cir. 2003) ("[I]t is the language of the regulatory text, and not the preamble, that controls.").

[22] 2010 Proposal at 4163.

[23] NOPR at 4756.

The Filings Proposed By The Commission Would Be Unduly Burdensome and the Required Forms Do Not Exist

In the NOPR, the Commission has proposed Forms 401,[24] 402S,[25] 404,[26] 404A,[27] and 404S,[28] with filings required as frequently as on a daily basis. Attached as an appendix to COPE's comments is a chart that sets forth the information provided by the NOPR regarding: (1) the data elements to be provided in each form; (2) the frequency with which each form must be filed; and (3) the events that trigger filings. In addition to the above-referenced forms, it appears from the NOPR that a trader may also be required to file a "certification" confirming it has met the standards for the "special conditional spot-month limit."[29] The certification does not appear to have an associated form.

COPE is concerned that, rather than proposing specimen forms, the Commission has only provided a listing, at a high level, of the data that is expected to be included on these forms. As the Commission knows from its work in implementing Dodd-Frank, the devil is in the details. As a general matter, agencies that propose rules which require reporting and data collection typically propose, with specificity, the forms through which data will be submitted. This is particularly true when the forms are at the heart of the proposed rule, as is the case here. Without the ability to review and comment on the proposed forms, traders are not provided the opportunity to have notice of and to comment on significant aspects of the Position Limits NOPR.

Under the Administrative Procedure Act ("APA"),[30] while an agency need not publish in advance every precise proposal it may ultimately promulgate as a rule,[31] interested parties must be afforded a reasonable and meaningful opportunity to participate.[32] Courts have overturned administrative regulations on the ground of inadequate notice where the agency's general notice of the "subjects and issues" was not sufficient to advise groups vitally affected by the details of the rule to comment on those details.[33] The D.C. Circuit rejected the Environmental Protection Agency's ("EPA") adoption of a computer model because in the notice issued prior to its

---

[24] *Id.* at 4773, 4775 (proposed § 151.6(b); proposed § 151.9(b)(3)).

[25] *Id.* (proposed § 151.6(c); proposed § 151.9(b)(3)).

[26] *Id.* at 4771-4775 (proposed §§ 151.5(b), (f); proposed § 151.6(d); proposed § 151.9(b)).

[27] *Id.* (proposed §§ 151.5(c), (f); proposed § 151.6(d); proposed § 151.9(b)).

[28] *Id.* (proposed §§ 151.5(d), (f), (i); proposed § 151.9(b)).

[29] *Id.* at 4765.

[30] 5 U.S.C. § 553(b)(3) (2006).

[31] *See, e.g., Cal. Citizens Band Ass'n v. United States*, 375 F.2d 43, 48 (9th Cir. 1967).

[32] *See, e.g., Forester v. Consumer Prod. Safety Comm'n*, 559 F.2d 774, 787 (D.C. Cir. 1977).

[33] *See, e.g., Wagner Elec. Corp. v. Volpe*, 466 F.2d 1013, 1019 (3rd Cir. 1972) ("The absence of comment from such groups may well be because the notice of proposed rulemaking never advised of this subject or issue.").

adoption, EPA did not reference the model in its summary and suggested "more malleability and vagueness" than actually characterized the model.[34] Finding that adoption of the model constituted a rule, the Court stated that "[a]n agency may not introduce a proposed rule in this crabwise fashion."[35]

While COPE believes it has a sense of the data the Commission is proposing to collect, its understanding is only conjecture. Given the significance of the proposed forms to the Position Limits NOPR and the material impact the ultimate forms will have on the ability of affected persons to comply, traders that must file the required forms must be given the ability to comment on them before they are made part of a final rule or otherwise promulgated. The Commission must issue proposed Forms 401, 402S, 404, 404A, and 404S for notice and comment before taking any further action towards a position limits rule.

The reporting burdens associated with these forms under the NOPR's proposed regulations are confusing and significant. As COPE understands the reporting requirements, a trader anticipating exceeding applicable position limits pursuant to a transaction to which the proposed *bona fide* hedging exemption would be applicable must file a Form 404A at least ten days in advance of the date that such transactions or positions would be in excess of the position limits.[36] Another Form 404A must be filed by such a trader ten days in advance of a change in the applicable positions where the regulations require supplementary information to be filed.[37] In COPE's understanding of the proposed regulations, regardless of whether any such anticipatory filings have been made, Forms 404 and 404S must be filed for every day a trader actually exceeds position limits pursuant to transactions that qualify for such exemptions.[38] Form 404S must also be filed for each day the hedge exemption is relied upon by a counterparty.[39] Each of Forms 404, 404S, and 404A, as applicable, must also be filed where a position limit is exceeded pursuant to a *bona fide* hedge exemption in the hedging of commercial activity or positions resulting from swaps that are used for the hedging of commercial activity that does not involve the same quantity or commodity as the quantity or commodity associated with positions in referenced contracts that are used to hedge.[40] The confusion of the preceding sentence is not in COPE's formulation; it results directly from the NOPR's proposed filing requirements. These forms must be filed on the day after the limit is exceeded and the first day after the position is below the limit.[41]

---

[34] *McLouth Steel Prods. Corp. v. Thomas*, 838 F.2d 1317, 1322-23 (1988).

[35] *Id.*

[36] NOPR at 4772 (proposed § 151.5(c)(1)).

[37] *Id.* (proposed § 151.5(c)(3)).

[38] *Id.* at 4772, 4775 (proposed §§ 151.5(b), (d); proposed § 151.10(b)(2).

[39] *Id.* at 4772 (proposed § 151.5(b)).

[40] *Id.* (proposed § 151.5(f)).

[41] *Id.* at 4775 (proposed § 151.10(b)).

Adding to the confusion and reporting burdens, traders are obligated under the NOPR's proposals to file Forms 404, 404A, and 401 or 402S (as applicable) when certain position visibility limits are exceeded.[42] A Form 401 must be filed for each position in referenced contracts in the same commodity that reaches or exceeds a visibility level; separately, a Form 402S must be filed for each position in referenced contracts in the same commodity that reaches or exceeds a visibility level for any uncleared swap position based on substantially the same commodity as that which underlies the referenced contract.[43] These filings are required to be made by the later of 9 a.m. five business days after the time the applicable visibility level is reached or exceeded; or 9 a.m. on the first business day of the subsequent calendar month.[44] The NOPR's proposed filing requirements for exceeding visibility levels do not stop there. Forms 404 and 404A must also be filed within the same timeline for any applicable positions exceeding visibility levels.[45]

Transactions For the Purpose of Hedging or Mitigating Commercial Risk Must Qualify as *Bona Fide* Hedges

The end-user exception included in Dodd-Frank permits hedgers that are, *inter alia*, entering into transactions for the purpose of hedging or mitigating commercial risk to opt out of clearing.[46] As noted in COPE's comments to the Commission's proposed rulemaking regarding End-User Exception to Mandatory Clearing of Swaps, the Commission has proposed a workable and broad definition of the term "hedging or mitigating commercial risk."[47]

In the Position Limits NOPR, the Commission has listed certain Enumerated Hedging Transactions as meriting a *bona fide* hedge exemption.[48] As proposed by the Commission, it is unclear whether the list is exclusive since the proposed regulation states that the definition of *bona fide* hedge hedging transaction "includes" the listed transactions.[49]

If the Commission issues a final rule, it should clarify the regulatory text to make clear that the "Enumerated Hedging Transactions" is non-exclusive. Further, it should make clear that any transaction that meets the test of hedging or mitigating commercial risk such that it qualifies for the end-user exception also qualifies as a *bona fide* hedge transaction. Any other approach would create a self-contradictory regulatory regime in which a single concept has multiple differing meanings without any logical basis for a distinction.

---

[42] *See id.* at 4773 (proposed §§ 151.6(b), (c) and (d)).

[43] *Id.* (proposed §§ 151.6(b), (c)).

[44] *Id.* at 4775 (proposed § 151.1(b)(3)).

[45] *Id.* at 4773 (proposed § 151.6(d)).

[46] Dodd-Frank § 723 (as codified at 7 U.S.C. § 2(h)(7)(A)); *see also* 75 Fed. Reg. 80747 at 80748.

[47] *See Comments of Coalition of Physical Energy Companies to End-User Exception to Mandatory Clearing of Swaps*, February 22, 2011.

[48] NOPR at 4771 (proposed § 151.5(a)(2)).

[49] *Id.*

The Hedge Exemption/Position Visibility Process Is Unclear

COPE believes the hedge exemption process should be clarified. As COPE understands it, the Commission is not proposing a requirement that a trader obtain a hedge exemption prior to exceeding position limits. Instead, a trader is generically granted an exemption to position limits for its *bona fide* hedging transactions as long as it files a Form 404 by 9 a.m. the day after exceeding the position limit.[50] The *bona fide* exemption does not implicate the "crowding out" concept that was proposed in the prior position limits NOPR.[51] Thus, a trader can hold speculative positions below the limit and *bona fide* hedging positions above the limit.

While not required, a trader can also obtain an anticipatory hedge exemption which must be approved by the Commission by filing a Form 404A at least ten days prior to exceeding a position limit.[52] Supplemental reports are also required if the anticipated requirements or production set forth in the Form 404A change.[53] In the event a trader exceeds the position limits and has an anticipatory hedge exemption, it still must file a Form 404 by 9 a.m. the day after exceeding the position limit.[54]

In addition to filing the forms, traders that "qualify for *bona fide* hedge exemptions" must also "maintain complete books and records concerning all of their related cash, futures, and swap positions and transactions and make such books and records, along with a list of swap counterparties, available to the Commission upon request."[55]

With regard to the position visibility levels, as COPE understands the proposals, the filings related to such levels include not only data on a trader's holdings but also certifications concerning uncleared swaps and cash positions.[56] The filings required are expected to be set at levels below position limits for the same commodities. The related filings do not have any role in controlling "excessive speculation."

It is also unclear from the NOPR whether market participants will continue to seek exchange-based hedge exemptions from the exchanges themselves or from the Commission. COPE members are aware of uncertainty among the exchanges as to whether applications for hedge exemptions from position limits will first be directed to the exchanges, who will then have to pass those applications seeking exemption along to the Commission. Further, it is uncertain, based on the NOPR, if a trader exceeds a position limit, whether the requisite forms to be filed as a result must be filed only with the Commission or if they must also be filed with the exchanges.

---

[50] *Id.* at 4775 (proposed § 151.10(b)(3)).

[51] 2010 Proposal at 4159.

[52] NOPR at 4765 (proposed § 151.5(c)(1)).

[53] *Id.* at 4766 (proposed § 151.5(c)(3)).

[54] *Id.* at 4775 (proposed § 151.10(b)(3)).

[55] *Id.* at 4772 (proposed § 151.5(e)).

[56] *Id.* at 4773 (proposed § 151.6(b)(4)).

The Commission must clarify the foregoing and establish a clear and efficient hedge exemption process.

Given the ambiguity in the Position Limits NOPR, COPE requests that the Commission confirm that the foregoing is correct. Assuming it is, COPE seeks the following clarifications and revisions.

1. If a trader exceeds position limits using the generic hedge exemption and files a timely Form 404 in good faith, the trader should not be subject to sanctions if the Commission finds fault with the trader's understanding of the validity of its hedging activity. Only intentional violations of limits should be subject to punishment.

2. If a trader timely files a Form 404A, it should be able to rely upon the requested anticipatory hedge exemption ten days thereafter. A trader's ability to hedge its commercial risk should not be impacted by a delay in the Commission's review and approval of its filing. If the Commission were to find, at a later time, that the requested exemption is unwarranted, the anticipatory hedge exemption could be prospectively terminated.

3. The Commission should confirm that "complete books and records" does not intend any additional obligations beyond the current trade capture and recordation systems typically in place today. The Commission should also limit its "books and records" retention requirement to a period of one year.

4. As set forth above, the process required of traders to track and comply with the NOPR is materially burdensome. Given the significant overall burden of Dodd-Frank implementation, the Commission should decline to implement its proposed position visibility regulations, even if it implements position limits. The value of position limits is limited at best. Comparing the burden of position visibility compliance to its value demonstrates that such regulations are not worth the cost. For example, what will the Commission do with the hundreds of forms that will be filed daily for *bona fide* hedges and position visibility? Unless the Commission is planning to devote its resources to reviewing these filings, position visibility does not even serve an informational purpose.

5. In the same vein as Item No. 4, the Commission should eliminate any requirement for any daily filings, particularly *bona fide* hedge-related filings. Unless such filings will be reviewed on a daily basis by the Commission, a trader should be able to file monthly aggregated filings. This will reduce the compliance burden and still permit the Commission to receive needed information.

6. The Commission should confirm that intracorporate transactions between wholly-owned affiliates will not count towards the applicable position limits.

The Approval Process for Waiver of Aggregation of Positions Requires Unnecessary Burdens

Unlike the Commission's 2010 Proposal, the Position Limits NOPR provides entities with ten percent direct or indirect common ownership or control to receive an exemption of the requirement that their positions be aggregated for position limits purposes if they can effectively demonstrate that each operates independently of one another.[57] This is an improvement over the prior proposal and, if implemented efficiently, will avoid the significant disruptions in energy markets where common ownership with independent and separate operations is not uncommon.

However, the manner in which the Commission has proposed to implement the waiver is problematic and inefficient. As proposed, prior to receiving an exemption, commonly owned traders are required to submit a detailed application to the Commission as well as provide any additional information required by the Commission.[58] Until the Commission grants an exemption, the positions must be aggregated.

Given the material workload faced by the Commission, it appears to COPE that it will take the Commission a significant amount of time to process such applications. In the meantime, entities that operate independently, do not share data, and may be commercially or legally precluded from sharing data will be subject to aggregation of their positions for Position Limits purposes. This is true even for firms for which data sharing is legally barred.

COPE asks the Commission to recognize this circumstance and permit persons that have filed for exemptions in good faith to receive an immediate preliminary exemption, which would become permanent upon action by the Commission. Any other approach will be materially disruptive to the market.

Conclusion

COPE requests that the Commission not move forward with a final position limits rule. The Position Limits NOPR is not supported by empirical evidence and will impose a significant compliance burden on traders, their compliance personnel, and regulators alike. The Commission's already significant burden of market surveillance and enforcement, as increased by mandatory Dodd-Frank rulemakings, will only be further strained by unnecessary imposition of discretionary position limits that will prove as difficult to enforce as they will be to comply with. Rather than continue to pursue a position limits rule, the Commission should focus its resources on the mandatory aspects of Dodd-Frank and not burden itself and market participants with additional and questionable compliance obligations.

---

[57] *Id.* at 4756.

[58] *Id.* at 4761.

Respectfully submitted,

/s/ David M. Perlman

David M. Perlman
Bracewell & Giuliani LLP
2000 K St. NW, Suite 500
Washington, D.C. 20006
T: (202) 828-5804
david.perlman@bgllp.com

Counsel to
Coalition of Physical Energy Companies

cc: COPE Members

Form 404 – Hedges Exceeding Position Limits

Information to be included:

(1) The cash market commodity hedged, the units in which it is measured, and the corresponding referenced contract that is used for hedging the cash market commodity;

(2) The number of referenced contracts used for hedging;

(3) The entire quantity of stocks owned of the cash market commodity that is being hedged by a position in a referenced contract;

(4) The entire quantity of open fixed price purchase commitments in the hedged commodity outside of the spot month of the corresponding referenced contract;

(5) The entire quantity of open fixed price purchase commitments in the hedged commodity in the spot month of the corresponding referenced contract;

(6) The entire quantity of open fixed price sale commitments in the hedged commodity outside of the spot month of the corresponding referenced contract; and

(7) The entire quantity of open fixed price sale commitments in the hedged commodity in the spot month of the corresponding referenced contract.

Frequency of filing:

(1) Where a position limit is exceeded pursuant to a *bona fide* hedge exemption – (a) the day after: the position limit is exceeded; and all days the trader exceeds such levels, and (b) the first day after the trader's position is below the position limit;

(2) Where a position visibility level is exceeded – after the establishment of a position exceeding a visibility level on the later of either (a) 9 a.m. five business days after such time; or (b) 9 a.m. the first business day of the subsequent calendar month. In either case, the filing is required no more often than once per calendar month.

Form 404A -- Anticipatory Hedge Exemption

Information to be included:

(i) The cash market commodity and units for which the anticipated production or requirements pertain;

(ii) The dates for the beginning and end of the period for which the person claims the anticipatory hedge exemption is required, which may not exceed one year;

(iii) The production or requirement of that cash market commodity for the three complete fiscal years preceding the current fiscal year;

(iv) The anticipated production or requirements for the period hedged, which may not exceed one year;

(v) The unsold anticipated production or unfilled anticipated requirements across the period hedged, which may not exceed one year;

(vi) The referenced contract that the trader will use to hedge the unfilled, anticipated production or requirements; and

(vii) The number of referenced contracts that will be used for hedging.

Supplementary Reports:

Whenever the sales or purchases which a person wishes to consider as *bona fide* hedging of unsold anticipated production or unfilled anticipated requirements shall exceed the amounts in the most recent filing or the amounts determined by the Commission to constitute unsold anticipated production or unfilled anticipated requirements in its approval of a anticipatory hedge exemption, such person shall file with the Commission a statement which updates the information provided in the person's most recent filing, and for instances where anticipated needs exceed the amounts in the most recent filing.

Frequency of filing:

(1) Where a trader wishes to exceed position limits pursuant to a *bona fide* hedge exemption in order to hedge unsold anticipated commercial production or unfilled anticipated commercial requirements connected to a commodity underlying a referenced contract - at least ten days in advance of the date that such transactions or positions would be in excess of the position limits.

(2) Where a supplementary report is required to a previously filed Form 404A for an anticipatory hedge exemption: at least ten days in advance of the date that person wishes to exceed the previous amounts.

(3) Where a position visibility level is exceeded – after the establishment of a position exceeding a visibility level on the later of either (a) 9 a.m. five business days after such time; or (b) 9 a.m. the first business day of the subsequent calendar month. In either case, the filing is required no more often than once per calendar month.

Form 404S - Hedges Exceeding Position Limits (Additional Information From Counterparties)

Information to be included:

(1) The commodity reference price for the swaps that would qualify as a *bona fide* hedging transaction or position;

(2) The entire gross long and gross short quantity underlying the swaps that were executed in a transaction that would qualify as a *bona fide* hedging transaction, and the units in which the quantity is measured;

(3) The referenced contract that is used to offset the exposure obtained from the *bona fide* hedging transaction or position of the counterparty;

(4) The gross long or gross short size of the position used to offset the exposure obtained from a *bona fide* hedging transaction or position of the counterparty;

(5) The gross long or gross short size of the position used to offset the exposure obtained from a *bona fide* hedging swap transaction or position that is in the spot month.

Frequency of filing:

(1) Where a position limit is exceeded pursuant to a *bona fide* hedge exemption – (a) the day after: the position limit is exceeded; and all days the trader exceeds such levels, and (b) the first day after the trader's position is below the position limit;

(2) Where a position visibility level is exceeded – after the establishment of a position exceeding a visibility level on the later of either (a) 9 a.m. five business days after such time; or (b) 9 a.m. the first business day of the subsequent calendar month. In either case, the filing is required no more often than once per calendar month.

Form 401 – Visibility Levels

Information to be included:

For each position in referenced contracts in the same commodity that reaches or exceeds a visibility level, a trader must submit for each contract comprising the position:

(1) The date on which the trader's position initially reached or exceeded the visibility level;

(2) Gross long and gross short positions on an all-months-combined basis (using economically reasonable and analytically supported deltas);

(3) If the visibility levels are reached or exceeded in any single month, the contract month and the trader's gross long and short positions in the relevant single month (using economically reasonable and analytically supported deltas); and

(4) If applicable, the trader shall also certify that they do not hold or control positions subject to the filing requirements for related uncleared swaps positions (Form 402S) or for exceeding position limits or visibility levels pursuant to *bona fide* hedges (Forms 404 and 404A).

Frequency of filing:

After the establishment of a position exceeding a visibility level on the later of either (a) 9 a.m. five business days after such time; or (b) 9 a.m. the first business day of the subsequent calendar month. In either case, the filing is required no more often than once per calendar month.

Form 402S – Visibility Levels – Same Commodity

Information to be included:

For each position in referenced contracts in the same commodity that reaches or exceeds a visibility level, a trader must submit the following information for the date on which the trader's position initially reached or exceeded the visibility limit for any uncleared swap position based on substantially the same commodity as that which underlies the referenced contract:

(1) By commodity reference price;

(2) By swaps or swaptions;

(3) By open swap end dates within 30 days, 90 days, one year or outside of one year from the date on which the trader's position initially reached or exceeded the visibility level; and

(4) Gross long and gross short positions on a futures equivalent basis in terms of the referenced contract.

With the express written permission of the Commission or its designees, the submission of a swaps portfolio summary statement spreadsheet in digital format may be substituted for the above form, only insofar as the spreadsheet provides at least the same data as that required by the 402S filing.

* * * *

Frequency of filing:

After the establishment of a position exceeding a visibility level on the later of either (a) 9 a.m. five business days after such time; or (b) 9 a.m. the first business day of the subsequent calendar month. In either case, the filing is required no more often than once per calendar month.

Triggering of Report Filings

Where a position limit is exceeded pursuant to a *bona fide* hedge exemption – **Forms 404 and 404S**

Where a trader wishes to exceed position limits pursuant to a *bona fide* hedge exemption in order to hedge certain unsold anticipated commercial production or unfilled anticipated commercial requirements – **Form 404A**

Where a position visibility level is exceeded – **Forms 404, 404A, 404S, and 401 or 402S (as applicable)**

Where a position limit is exceeded pursuant to a *bona fide* hedge exemption by a traders engaged in the hedging of commercial activity or positions resulting from swaps that are used for the hedging of commercial activity that does not involve the same quantity or commodity as the quantity or commodity associated with positions in referenced contracts that are used to hedge – **Forms 404 and 404S, or 404A as applicable**