March 1, 2012

Via Electronic Submission

David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Petitions for Order to Exempt Owned Non-Financial Entities from Aggregation for Compliance with Position Limits and Order to Broaden and Clarify Rule 151.7(i)

Dear Mr. Stawick:

The Edison Electric Institute ("**EEI**") and the American Gas Association ("**AGA**") (hereafter "**Joint Associations**") respectfully submit these comments in support of the Working Group of Commercial Energy Firms' ("**Working Group**") Petitions to the Commodity Futures Trading Commission (the "**Commission**") requesting orders granting exemptive relief from the aggregation requirements of the Commission's regulations establishing speculative position limits ("**Position Limits Rule**") (the "**Petition**").[1] The Commission has the authority to "exempt, conditionally or unconditionally . . . any transaction or class of transactions from any requirement it may establish . . . with respect to position limits" under Section 4a(a)(7) of the Commodity Exchange Act ("**CEA**").[2] For the reasons discussed below, the Joint Associations request that the Commission grant the Working Group's Petition for exemptive relief from the aggregation requirements of position limits by reinstating the proposed owned non-financial entity ("**ONFE**") exemption and clarifying the exemption for when the sharing of information for purposes of aggregation would cause a violation of Federal law ("**Violation of Federal Law Exemption**").

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[1] The Working Group filed two separate petitions for exemptive relief from the aggregation requirement in the Position Limits Rule. To avoid potential confusion, this letter refers to the Working Group's petitions collectively as the "Petition". *Position Limits for Futures and Swaps*, 76 Fed. Reg. 71626 (Nov. 18, 2011) [hereinafter *Position Limits Rule*].

[2] CEA Section 4a(a)(7).

I. The Joint Associations' Interest in the Petition and the Position Limits Rule

EEI is the association of U.S. shareholder-owned electric companies. EEI's members serve 95 percent of the ultimate customers in the shareholder-owned segment of the U.S. electricity industry, and represent approximately 70 percent of the U.S. electric power industry. EEI also has more than 65 international electric companies as Affiliate members, and more than 170 industry suppliers and related organizations as Associate members.

The AGA, founded in 1918, represents more than 200 local energy companies committed to the safe delivery of clean natural gas to more than 65 million customers throughout the United States. AGA's members use a variety of financial tools, such as futures contracts traded on CFTC-regulated exchanges and over-the-counter energy derivatives, to hedge the commercial risks associated with providing natural gas service, particularly volatility in natural gas commodity costs. AGA is an advocate for local natural gas utility companies and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international gas companies and industry associates. Today, natural gas meets almost one-fourth of the United States' energy needs.

The Joint Associations' members are physical commodity market participants that rely on swaps and futures contracts primarily to hedge and mitigate their commercial risk. They are not financial entities. Regulations that make effective risk management options more costly for end-users of swaps will likely result in higher and more volatile energy prices for residential, commercial, and industrial customers. As users of commodity swaps and futures contracts to hedge commercial risk, the Joint Associations' members have a significant interest in the Petition submitted by the Working Group.

Unless exemptive relief is granted, the Commission's Position Limits Rule would require an entity to aggregate all positions and accounts in which it directly or indirectly has a 10 percent or greater ownership or equity interest, regardless of whether the affiliated entities are actually subject to common control (the "**Aggregation Threshold**").[3] The Aggregation Threshold creates a significant compliance burden for commercial firms because of the rigorous level of coordination that it requires among entities with a 10 percent or greater common ownership interest. The Position Limits Rule requires all related commercial entities that exceed the Aggregation Threshold and that engage in transactions in Referenced Contracts to coordinate, on a global basis, as to all aspects of any transactions in Referenced Contracts in which they engage, regardless of whether they operate under common control or otherwise coordinate their activities. This requirement imposes significant operational challenges for commercial firms, requiring them to develop and maintain costly internal infrastructure mechanisms to ensure

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[3] *Position Limits Rule*, *supra* note 1, at 71692.

compliance.[4] Accordingly, the Joint Associations urge the Commission to grant the Working Group's Petition as expeditiously as possible, including granting the requested interim exemptive relief to prevent commercial firms from incurring needless compliance costs during the Commission's consideration of the Petition. Further, the Joint Associations request that the Commission make explicit that any exemptive relief it grants will apply to all market participants who satisfy the specified conditions of the relief.

II. The Commission Should Provide an Exemption from Aggregation that Allows All Market Participants to Disaggregate Positions in Referenced Contracts Held by Independently Managed and Controlled Owned Non-Financial Entities

In the Proposed Position Limits Rule, the Commission included an exemption from the Aggregation Threshold for owned non-financial entities.[5] Despite the fact that the ONFE exemption is consistent with the underlying purposes of the Commission's aggregation policy, the Commission, without prior notice to the public or any opportunity to comment, eliminated the ONFE exemption from the Position Limits Rule. In so doing, the Commission suggested incorrectly that due to the other exemptions included in the final rule, the ONFE exemption was not necessary.[6] The Joint Associations respectfully disagree with the Commission's apparent view that the ONFE exemption is not necessary. Most of the other exemptions provided in the Position Limits Rule, such as the independent account controller ("**IAC**") exemption, are of no practical use to most commercial firms.

As proposed, the ONFE exemption ameliorated the burdens caused by requiring aggregation based solely on an ownership interest for many end-users by "allow[ing] disaggregation primarily in the case of a conglomerate or holding company that 'merely has a passive ownership interest in one or more non-financial operating companies . . . .'"[7] The Joint

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[4] EEI has previously commented on the burdens of the Aggregation Threshold in its March 28, 2011 and January 17, 2012 comment letters. *See* Comments on Proposed Rule Regarding Position Limits for Derivatives (RIN 3038-AD15 and 3038-AD16) at 19-22 (March 28, 2011); Comments on Interim Final Rule Regarding Position Limits for Futures and Swaps (RIN 3038-AD17) at 14-16 (January 17, 2012).

[5] *Position Limits for Derivatives*, Proposed Rule, 76 Fed. Reg. 4752, 4762 [hereinafter *Proposed Rule*].

[6] Specifically, the Commission stated that in light of the Commission's decision to retain the independent account controller exemption, provide an exemption for Federal law information sharing restrictions, and provide an exemption for underwriting, that it was not necessary to expand the scope of disaggregation exemptions to owned non-financial or financial entities. *Position Limits Rule*, *supra* note 1, at 71654.

[7] *Position Limits Rule*, *supra* note 1, at 71653. The Commission included several indicia regarding independent control under the ONFE exemption, including: (1) control of trading decisions by persons employed exclusively by the ONFE, who do not in any way share trading control with persons employed by the ONFE; (2) maintenance and enforcement of written policies and procedures to preclude the ONFE or any of its affiliates from having knowledge of, or gaining access to, or receiving information or data about its positions, trades or trading strategies, including document routing and other procedures and security arrangements; and (3) maintenance of a separate risk management system from the ONFE and any of its other affiliates. *Proposed Rule*, *supra* note 5, at 4762-63.

Associations support reinstating the ONFE exemption and do not believe that the Commission should require a commercial company to aggregate the commonly-owned positions of an owned non-financial entity that is not subject to its direct and actual common control.[8]

The Commission has explained that "[t]he fundamental rationale for the aggregation of positions or accounts is the concern that a single trader, through common ownership or control of multiple accounts, may establish positions in excess of the position limits and thereby increase the risk of market manipulation or disruption."[9] An ownership interest of 10 percent generally is insufficient to enable the holder of that interest to control the trading of the owned entity. And, where common control is not exercised between related entities, there is no meaningful risk of coordinated trading. Accordingly, if an entity with a 10 percent or greater ownership interest in a non-financial entity can demonstrate that the trading operations of the owned non-financial entity are independently managed and controlled, disaggregation should be permitted. Reinstating the ONFE exemption would save commercial firms from developing and maintaining the costly internal infrastructure mechanisms necessary to comply with position limits when it would not further the Position Limits Rule's purpose of preventing excessive speculation and market manipulation.[10]

A. Requiring Aggregation of All Positions Held by Commonly Owned Entities, Regardless of Actual Control, is Commercially Impracticable

Compliance with the Position Limits Rule's Aggregation Threshold is impracticable for many of the Joint Associations' members. Commercial firms frequently have numerous related entities that, under the new position limits regime, would be required to coordinate as to whether, when, and how they engage in transactions in Referenced Contracts.[11] The Joint Associations are concerned that the technology necessary to coordinate trading among numerous affiliates does not yet exist and may be prohibitively expensive for firms to construct.

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[8] The Joint Associations request that the Commission adopt the ONFE exemption as proposed by the Working Group. In particular, as compared to the ONFE exemption included in the Proposed Rule, EEI previously has supported two modifications to the ONFE exemption that the Working Group has adopted: (1) the ONFE exemption should be effective when filed, consistent with the final IAC exemption, and (2) entities eligible for the ONFE exemption should be permitted to utilize risk management systems and personnel on an enterprise-wide basis across affiliates. *See* Comments on Proposed Rule Regarding Position Limits for Derivatives (RIN 3038-AD15 and 3038-AD16) at 7-9 (March 28, 2011).

[9] *Position Limits Rule*, *supra* note 1, at 71652.

[10] *Position Limits Rule*, *supra* note 1, at 71627 (The Commission shall set position limits "in order to protect against excessive speculation and manipulation while ensuring that the markets retain sufficient liquidity for bona fide hedgers ….").

[11] In addition to Commission-set position limits, the Joint Associations' members will also be subject to the same impracticable Aggregation Threshold for any exchange-set position limits that are established. 17 C.F.R. § 151.11(e).

In addition, as a practical matter, many commercial companies may have difficulty complying with the aggregation requirement because they are unable to convince or compel companies in which they have a small ownership interest, but which they do not control, to disclose and share on a real-time basis their trading and position information. The Joint Associations do not believe that the Commission should impose commercially impractical regulatory requirements on market participants where there is no compelling need in the absence of actual control.

B. Maintaining the Current Aggregation Threshold Could Cause Significant Market Disruptions and Decrease Competition and Liquidity in the Derivatives Markets

Many commercial companies enter into joint ventures with competitors to reduce costs, take advantage of economies of scale, and enable investments in new development projects that might not otherwise occur if the risks and expenses were borne by a single firm. Joint ventures make these projects easier to finance and less risky for commercial companies and their investors. As the Working Group notes, many commercial firms involved in joint ventures have, by contract and through policies and procedures, established information barriers to prevent joint ventures and other affiliates from sharing commercially sensitive information, including Referenced Contract position data, and pricing and inventory information. Compliance with the Position Limits Rule's aggregation requirement would require these companies to violate these contractual agreements and established policies. As a result, joint ventures and affiliates will likely have to renegotiate their contractual agreements and restructure their operations, policies and procedures in order to comply with position limits.

These restructurings could cause market disruptions and may reduce liquidity in certain sectors of the market place as companies reduce their underlying commercial operations and trading activity, and, in some cases, unwind their investments. Indeed, the Joint Associations are concerned that many commercial firms, wary of the complicated logistics of complying with the Aggregation Threshold, may be discouraged from making future investments in joint ventures or commercial companies. A disincentive to invest may reduce customer choice, limit the benefits of joint ventures, and exacerbate decreases in market liquidity.

In addition to the Joint Associations' concerns regarding market disruptions and reduced liquidity, communication among these commonly owned, but not controlled entities, that previously were unaware of one another's commercial operations and trading activities, has the potential to reduce competition in the market place. Accordingly, the Joint Associations respectfully request that the Commission exercise its authority under CEA Section 4a(a)(7) to preserve market liquidity, avoid unintended consequences, and prevent the imposition of unnecessary costs on commercial firms by reinstating the ONFE exemption from aggregation.

III. The Commission Should Expand the "Violation of Federal Law Exemption" to Include Activity that Could Cause a Violation of Federal or State Law

The Violation of Federal Law Exemption permits disaggregation in situations where the "sharing of information associated with such aggregation would cause either person to violate Federal law or regulations adopted thereunder and provided that such a person does not have actual knowledge of information associated with such aggregation."[12] In order to claim the exemption, the company must file a prior notice with the Commission describing the circumstances of the exemption and including an opinion of counsel that the sharing of information would cause a violation of Federal law or regulations adopted thereunder.[13]

The Joint Associations agree with the Working Group that the Commission should expand the Violation of Federal Law Exemption to include circumstances that *could cause* a person to violate international, federal, state, or local law, or regulations adopted thereunder, or an order of a federal or state regulatory authority, provided that such person does not have actual knowledge of information associated with such aggregation. The Joint Associations believe that the standard included in Rule 151.7(i) – that information sharing "would cause" a violation of federal law – is too high.[14] There are few situations where information sharing between joint venture partners would constitute a *per se* violation of federal law, but many situations where information sharing could create a *reasonable risk* of a violation of law.

Further, if the Violation of Federal Law Exemption is not expanded to encompass situations where information sharing could cause a violation of state or local law, then many commercial energy firms could be put in the position where compliance with the Federal Position Limits Rule's requirements results in a violation of state or local regulatory requirements. For example, many gas utilities face extensive regulation at the state and local level.[15] Frequently state and local regulations prohibit a regulated gas utility from sharing information or coordinating operations with affiliates or business units that are not regulated by a state commission. Many of the Joint Associations' members are subject to state and local

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[12] 17 C.F.R. § 151.7(i).

[13] *Id.*

[14] *See* EEI Comments on Interim Final Rule Regarding Position Limits for Futures and Swaps (RIN 3038-AD17) at 17-18 (January 17, 2012).

[15] *See* AGA Comments on Interim Final Rule Regarding Position Limits for Futures and Swaps (RIN 3038-AD17) at 5 (January 17, 2012).

regulations prohibiting the sharing of competitively sensitive information, such as Referenced Contract position data, among affiliated competitors.[16] In order to ensure that compliance with the Federal Position Limits Rule does not force firms to engage in information sharing that could violate state and local law, the Joint Associations urge the Commission to extend the Violation of Federal Law Exemption to state or local law, any regulations adopted thereunder, and orders of state regulatory authorities.

In addition, the Joint Associations request that the Commission eliminate the burdensome requirement that firms file an opinion of counsel with the Commission in order to claim the exemption.[17] Such opinions may prove difficult to obtain from counsel given the high standards that apply to the issuance of the opinions and the difficulty of meeting the high "would cause" standard. Accordingly, in order to ensure that the Violation of Federal Law Exemption is effective and complete, the Joint Associations request that the Commission refine and expand the Violation of Federal Law exemption by granting the Working Group's Petition and eliminating the requirement to obtain an opinion of counsel.

IV. Conclusion

The Joint Associations appreciate the Commission's consideration of our comments in support of the Working Group's Petition. For the reasons stated herein, we respectfully request that the Commission grant the Working Group's Petition as expeditiously as possible, including providing interim exemptive relief, to prevent our members from needlessly incurring significant expense to bring themselves into compliance with the new position limits regime. Reinstating the ONFE exemption and clarifying the scope of the Violation of Federal Law Exemption is consistent with the underlying purposes of the Commission's aggregation policies and helps to make the Aggregation Threshold commercially workable for our members.

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[16] The Working Group's Petition cites Texas Public Utility Code Substantive Rule 25.503 as an example of a state regulation that could conflict with a commercial company's obligations under the Position Limits Rule. Rule 25.503 prohibits a market participant from "collud[ing] with other market participants to manipulate the price or supply of power." The Joint Associations share the Working Group's concern that a company which shares its confidential trading data to comply with position limits could open itself up to a claim of collusion to the extent it does not share the trading data with other market participants.

[17] Both EEI and AGA have previously commented on the burdens imposed by requiring an opinion of counsel in their respective January 17, 2012 comment letters to the Commission. *See* EEI Comments on Interim Final Rule Regarding Position Limits for Futures and Swaps (RIN 3038-AD17) at 17-18 (January 17, 2012); AGA Comments on Interim Final Rule Regarding Position Limits for Futures and Swaps (RIN 3038-AD17) at 5 (January 17, 2012).

Please contact us at the numbers listed below if you have any questions regarding these comments.

Respectfully submitted,

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