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February 10, 2014

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

RE: RIN 3038–AD99;

Position Limits for Derivatives

Dear Secretary Stawick:

The National Energy Marketers Association ("NEM")[1]appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("Commission") above-referenced request for comments on the Commission's interim final rule that incorporates a trade option exemption into the final rules for commodity options.

NEM's membership is primarily comprised of Retail Energy Marketers (and suppliers who serve them), that sell electricity and natural gas to consumers as a competitive alternative to the local utility. Retail Energy Marketers primarily buy physical energy and physical and financial hedges necessary to provide consumers with the physical energy they want at a price (or price structure) they want. For example, Retail Energy Marketers often purchase wholesale physical natural gas and electricity on a spot (delivery) month (day) basis and purchase financial hedges to lock in prices for any consumers who want a long-term fixed price contract. Energy marketers as well as their suppliers are not financial entities and are not dealers as contemplated in the legislative history of the Dodd-Frank Legislation.[2]

The Commission is undertaking a rulemaking to set position limits for Reference Contracts linked to 28 futures. The NYMEX NG contract and the swaps, options and

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[1]NEM is a non-profit trade association representing both leading suppliers and major consumers of natural gas and electricity as well as energy-related products, services, information and advanced technologies throughout the United States, Canada and the European Union. NEM's membership includes independent power producers, suppliers of distributed generation, energy brokers, power traders, global commodity exchanges and clearing solutions, demand side and load management firms, direct marketing organizations, billing, back office, customer service and related information technology providers. NEM members also include inventors, patent holders, systems integrators, and developers of advanced metering, solar, fuel cell, lighting and power line technologies.

[2]See NEM Comments RIN 3038-AD06, RIN 3038-AD10, RIN 3038–AC98, dated February 22, 2011, at pages 2-3.

futures that are equivalent to it at Henry Hub is the core reference contract to most of NEM's members -- both its natural gas marketers and its electricity marketers. Indeed, since natural gas is the fuel for marginal generators during many of the peak hours of the year, it particularly drives the price of power in many Independent System Operator (ISO) markets, as was witnessed in the PJM, NYISO and ISO-NE markets this January. NEM and its members have three major concerns:

> 1. The anti-competitive impact of proposed rule 150.1(3)(iii)(B) that would favor utility monopolies whose commodity purchases are regulated by the public utility commissions in comparison with their competitive retail energy marketer counterparts that engage in the same hedging activities;
> 2. Restrictions on the cross-commodity hedging of power purchases with the Natural Gas contract in proposed rule 150.1(5); and
> 3. The proposed rule does not include a bona fide hedging exemption for hedging anticipated injections and withdrawals of natural gas into and from storage.

1. Anti-competitive clause

One of the enumerated hedges set forth in proposed part 150.1 is "Hedges of unfilled requirements." The last section of that proposed exemption includes the phrase:

> (B) Long positions in commodity derivative contracts that do not exceed in quantity unfilled anticipated requirements of the same cash commodity for resale by a utility that is required or encouraged to hedge by its public utility commission on behalf of its customers' anticipated use.

On its face, this provision would favor the historic regulated utility monopolies that hedge commodity services in comparison with competitive retail energy marketers that provide the same hedging services to their customers. The unintended consequence of this proposed utility-only exemption is to provide an unfair competitive advantage to the incumbent utility monopoly, which stands in stark contrast to this Commission's long-standing policy in favor of competition and competitive markets.

To avoid these unfair anti-competitive impacts, NEM recommends one of two actions:

> a. Eliminate part 150.1(3)(iii)(B) altogether, or
> b. Modify part 150.1(3)(iii)(B) in a competitively neutral fashion to read as follows,
>
> (B) Long positions in commodity derivative contracts that do not exceed in quantity unfilled anticipated requirements of the same cash commodity for resale by <u>an entity that is hedging</u> on behalf of its customers' anticipated <u>energy</u> use. (proposed language modifications are underlined).

This modification is consistent with the Commission's original justification for this special exemption of the proposed rule:

> The Commission is proposing a new exemption for unfilled anticipated requirements for resale by a utility. This provision is analogous to the unfilled anticipated requirements provision of paragraph (3)(iii)(A), except the commodity is not for use by the same person—that is, the utility—but rather for anticipated use by the utility's customers.[3]

NEM's proposed language change would also ensure that one class of market participant (utility monopoly) is not favored over another (retail energy marketer).

2. Using natural gas (NG) as a cross-commodity hedge for power into the spot month.

The proposed rule in Section 150.1(5) precludes entities from using cross-commodity hedges during the final five days before a core reference futures contract settles,

> (5) *Cross-commodity hedges.* Positions in commodity derivative contracts described in paragraph (2)(ii), paragraphs (3)(i) through (iv) and paragraphs (4)(i) through (iv) of this definition may also be used to offset the risks arising from a commodity other than the same cash commodity underlying a commodity derivative contract, *provided that* the fluctuations in value of the position in the commodity derivative contract, or the commodity underlying the commodity derivative contract, are substantially related to the fluctuations in value of the actual or anticipated cash position or pass-through swap and no such position is maintained in any physical- delivery commodity derivative contract during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract.[4]

In addition, the Commission questions the effectiveness of natural gas as an effective hedge of electricity.[5] Focusing for a moment on Texas[6] where ALL of the retail electricity users are served by competitive retail marketers, NEM notes that one of the dominant contracts is the Heat Rate contract. That is, market participants are willing to tie their procurement of wholesale market electricity to heat rate, which is a fixed multiplier of the NG contract price (thereby yielding a 100% correlation with the NG contract). With natural gas as the dominant fuel for generators, particularly for the generators whose bids typically set the market price in the ISO electricity market, many Texas market participants (including competitive retail marketers and their suppliers) see the ability to use the cross-commodity heat rate hedge as protection as valuable, or more

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[3] NOPR at 75713.
[4] NOPR at 75824.
[5] NOPR at 75717-8.
[6] The heat rate hedge is used elsewhere in the country (especially with the increased use of natural gas from shale deposits) but not as prevalently as in Texas.

valuable, than other ways of hedging. The prevalence of its use has led the exchanges to offer a number of heat rate contracts, including physically settled futures on ICE. Thus, NEM requests that the Commission remove the "5 day" rule restriction and allow cross-commodity hedges to continue into the spot month.

3. The Proposed Rule should provide a bona fide hedging exemption for anticipated injections into and withdrawals from storage.

The definition of "Bona fide hedging position" set forth in Section 150.1 of the proposed rule should expressly include the hedging of anticipated injections of natural gas into, and withdrawals out of, storage space held by Retail Energy Marketers. Many Retail Energy Marketers lease storage capacity, at a cost, in underground natural gas storage fields to assist in meeting natural gas delivery requirements to their retail customers during times of peak need, such as during the cold winter months. Retail Energy Marketers typically contract for such storage capacity directly from FERC-regulated pipelines and storage companies and/or they are assigned such storage rights, along with associated lease payment obligations, on a mandatory basis from state-regulated gas utilities upon enrolling residential and certain other retail customers. Tariff provisions frequently mandate when the Retail Energy Marketer must fill and empty such storage.

Retail Energy Marketers typically fill such storage capacity during the summer injection period and withdraw gas during the higher usage winter months to meet expected customer use. To effectively hedge injections and withdrawals of natural gas into and out of storage, marketers frequently buy natural gas futures contracts for the summer injection months and at the same time sell offsetting natural gas futures contracts for the winter withdrawal months to lock in the price spread between the two seasons and protect against a fall in winter prices before the gas can be withdrawn and sold to retail customers. These hedges typically qualify for hedge accounting treatment under current authoritative accounting guidance and are often put in place before the actual physical injection of gas occurs for both operational planning and pricing purposes. The contemporaneous hedging of natural gas injections and withdrawals by Retail Energy Marketers helps protect them from the scenario where winter NYMEX natural gas futures settlement prices fall below summer NYMEX natural gas futures settlement prices, as dramatically occurred during the winter of 2008/2009 when winter natural gas futures settled at prices far lower than the prices of futures that settled during the preceding summer. Moreover, as demonstrated by the recent "polar vortexes" pummeling the United States, natural gas storage space is a necessity for gas marketers in order to meet peak day customer demands; entering into offsetting sales and purchases of natural gas derivative contracts to capture calendar spreads helps marketers cover the cost of leasing such storage space.

Accordingly, NEM proposes that the Commission reinstate the bona fide hedging exemption for anticipated merchandising hedges originally contained in Section 151.5(a)(2)(v) of the vacated final rule.

NEM appreciates this and previous opportunities provided by the Commission for stakeholders to provide input as the Commission undertakes the significant and complex task of implementing the Dodd-Frank Act. We would be pleased to provide any additional information that the Commission may request.

Respectfully submitted,

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