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February 10, 2014

Via Electronic Submission

Melissa Jurgens, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Position Limits for Derivatives (RIN Number 3038-AD99)

Dear Ms. Jurgens:

Calpine Corporation ("Calpine") appreciates the opportunity to provide the Commodity Futures Trading Commission ("Commission" or "CFTC") with comments and recommendations in response to the Commission's Notice of Proposed Rulemaking concerning *Position Limits for Derivatives*, 78 Fed. Reg. 75680 (Dec. 12, 2013) ("Proposed Rule"). The Proposed Rule establishes position limits applicable to 28 Core Referenced Futures Contracts ("CRFC") and contracts that are directly or indirectly linked to a CRFC (collectively "Referenced Contracts"). Calpine's comments focus on the impact of the Proposed Rule on end-users, such as Calpine, who rely on the derivatives markets primarily to hedge or mitigate commercial risk.

Calpine is one of the largest independent wholesale power companies in the United States measured by power produced – in 2013 Calpine produced 104 billion kilowatt hours of electricity. We own and operate one of the largest fleets of natural gas-fired power plants in the U.S., which includes the largest fleet of natural gas-fired cogeneration plants that provide steam and power to our industrial and agricultural customers. Our portfolio consists of 94 power plants with an aggregate generation capacity of 29,154 megawatts ("MWs") and 699 MWs under construction.[1] Our fleet includes 76 natural gas-fired combustion turbine-based plants.[2] We are located in 20 states and Canada, and maintain a significant presence in major competitive wholesale power markets in California, Texas, and the Mid-Atlantic region.

Since Calpine's inception in 1984, we have invested in clean power generation to become a recognized leader in sustainability by developing, constructing, owning, and operating an environmentally responsible portfolio of power plants. Our business thesis has

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[1] This includes three plants under construction and a pending plant acquisition expected to close this quarter, as well as two plants located in Canada.

[2] Two oil-fired steam-based plants, 15 geothermal steam turbine-based plants, and one photovoltaic solar plant round out our fleet.

long centered on natural gas-fired generation as the cleanest, most reliable, flexible and affordable generation resource. The shale gas revolution has further strengthened our commitment to this fuel selection. Our plants also provide the critical services needed to help integrate intermittent renewable generation resources, such as wind and solar into the grid.

We sell wholesale power, steam, capacity, renewable energy credits, and ancillary services to our customers, who include utilities, independent electric system operators, industrial and agricultural companies, retail power providers, municipalities, power marketers, and others. We enter into natural gas transportation and storage arrangements to assure fuel delivery to our plants and we purchase electric transmission rights to enable us to deliver power to our customers.

Finally, and most relevant to this filing, we purchase natural gas and oil as fuel for our power plants – *e.g.*, in 2013 we consumed 782 billion cubic feet or approximately 10% of the total estimated natural gas consumed for power generation in the U.S. The magnitude of our exposure to natural gas and power prices and the volatility of spot gas and power prices creates meaningful risk which we manage by entering into natural gas and power contracts, both physical and financial, to hedge those business risks and optimize our portfolio of power plants. These risk-management tools mitigate the volatility of buying in the underlying cash markets, particularly in the spot gas and power markets, which in turn reduces power price volatility for ultimate consumers.

In short, Calpine is a classic and major end-user who must hedge commodity price risk in order to serve our customers and shareholders. We appreciate that the Proposed Rule seeks to address issues with financial institutions who historically have participated in the commodity derivatives markets, providing critical liquidity and products tailored to end-user needs. Regrettably, the Proposed Rule goes far beyond addressing the issues mandated under the Dodd-Frank Act and effectively seeks to redesign the market. In doing so, the Proposed Rule will adversely and unnecessarily impact end-users like Calpine to the detriment not only of the end-users and their investors, but ultimately to market efficiency and hence consumer prices. We are concerned that the Proposed Rule will stifle market liquidity, result in less efficient pricing, and impose undue administrative burdens on end-users.

Calpine supports the comments submitted by the Edison Electric Institute ("EEI") and the Electric Power Suppliers Association ("EPSA"), as well as those of the Futures Industry Association ("FIA").[3] However, we think it is important that the Commission hear directly from us as well. Our comments are intended to supplement the comments made in the EEI/EPSA and FIA letters.

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[3] *See* Letter from FIA, to Commodity Futures Trading Comm'n (Feb. 6, 2014) ("FIA Letter"); Letter from EEI and EPSA, to Commodity Futures Trading Comm'n (Feb. 10, 2014) ("EEI/EPSA Letter"); Letter from EPSA, to Commodity Futures Trading Comm'n (Feb. 10, 2014).

I. The Commission Should Adopt the CME-Group's Estimates of Deliverable Supply for Spot Month Limits

Under the Proposed Rule, the Commission proposes to establish spot month limits for 28 CRFCs, which are set based on a formula of 25 percent of the deliverable supply of the commodity underlying the CRFC. For the initial position limits, the Proposed Rule relies on the existing position limits set by the exchanges. The Commission also requested comment regarding alternative estimates of deliverable supply submitted by the CME Group ("CME").

Calpine supports CME's alternative estimates of deliverable supply for certain CRFCs. In particular, Calpine supports the alternative estimates for the four energy CRFCs. Given the expertise of the exchanges and their access to data to evaluate deliverable supply, the Commission should continue to defer to the exchanges when evaluating levels of deliverable supply. The CME's estimates reflect the most current amount of deliverable supply. As a result, the Commission should take these estimates into account so that any position limits it imposes will reflect 25 percent of actual deliverable supply available in the market.

II. The Commission Should Adopt Position Accountability Levels as Opposed to Hard Limits Outside of the Spot Month

The Proposed Rule establishes hard non-spot month speculative position limits for Referenced Contracts based on 10 percent of open interest for the first 25,000 contracts and 2.5 percent of open interest thereafter. If, despite the absence of a demonstrable need for position limits, the Commission nevertheless decides to impose restrictions on positions in Referenced Contracts outside of the spot month, Calpine recommends that the Commission adopt position accountability levels rather than hard position limits. Historically, if a market participant exceeded a position accountability level, the exchanges had the authority to request additional information from the market participant and potentially order the market participant to reduce its position.[4] By comparison, a position in excess of a position limit constitutes a violation, even if the positions do not constitute excessive speculation. Position accountability levels provide the Commission – and have historically provided the exchanges – with the flexibility to evaluate large positions within the context of the market for a particular commodity.

Based on the proposed limit levels, Calpine projects that the non-spot month limits will significantly impact its ability to hedge commercial risk. For example, the prices for many of Calpine's natural gas physical contracts are tied to the NYMEX Henry Hub futures contract. As a result, Calpine relies on Henry Hub futures contract positions out the curve to manage our commercial risk. Similar to the concerns described in the FIA and EEI/EPSA letters, Calpine is concerned that the Commission's overly restrictive definition of *bona fide* hedging position

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[4] *See, e.g.*, CME Rule 560.

may force Calpine to treat risk reducing positions as speculative positions.[5] Should the Commission adopt the final definition of *bona fide* hedging position as proposed, Calpine would have to manage risk reducing positions that do not qualify as *bona fide* hedging positions within the speculative limit. In contrast, under a position accountability regime, Calpine could demonstrate in response to a special call that its positions are risk reducing, and thus should not be characterized as speculative. We believe this is a pragmatic approach that does not compromise the Commission's objectives.

Furthermore, if the Commission imposes hard limits, Calpine would need to expend significant resources to ensure that its information technology systems could identify, gather, and report *bona fide* hedging positions in accordance with the requirements of the Commission's reporting forms. On the other hand, if the Commission adopts position accountability levels, Calpine would be able to reply to a specific request for additional information using its own internal reports that have been designed to meet its specific commercial and risk-management needs. That approach would substantially reduce, if not eliminate, the burden on Calpine and other end-users of having to conform their information technology systems to the Commission's forms.

III. If the Commission Adopts Hard Position Limits Outside of the Spot Month, It Should Calculate Limits Based upon a Complete Set of Data

As noted above, the Commission proposes to establish non-spot month limits based on 10 percent of open interest for the first 25,000 contracts and 2.5 percent of open interest thereafter. However, when calculating open interest, the Commission relied on an incomplete set of open interest data, which resulted in lower limits when input into the Commission's open interest formula. In the Proposed Rule, the Commission stated that it only considered open interest during calendar years 2011 to 2012 for futures contracts, options on futures contracts, and significant price discovery contracts. It did not consider open interest from over-the-counter transactions.

The Commission has access to open interest data collected under the Part 20 swaps large-trader reporting rule and data from swaps reported to swap data repositories. It should use these open interest data when setting non-spot month speculative position limits. If the Commission does not include these data as part of its calculation of open interest, then speculative position limits will not represent 10 percent of open interest for the first 25,000 contracts and 2.5 percent thereafter. As a result, the Commission's non-spot month limits will not be set at an appropriate level, as required by CEA section 4a(a)(3)(B).

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[5] *See* FIA Letter section IX.E; *see also* EEI/EPSA Letter section VII.

IV. Trade Options Should Not Be Subject to Position Limits

Commodity trade options are physical arrangements between commercial parties that should not be viewed as speculative in nature. Subjecting trade options to speculative position limits would be inconsistent with the Commission's trade option rule which requires that producers, processors, merchants, and commercial users enter into trade options for purposes *related to their business*.[6]

Calpine generally prefers to have optionality embedded in its physical natural gas contracts in order to address variability of weather and load impacting the amount of gas needed to fire its natural gas-powered plants. While we consider most of these contracts excluded forward contracts, to the extent that some of them constitute trade options, they may be subject to position limits if they are Referenced Contracts. Given the significant costs associated with monitoring positions toward a limit, including the costs of reporting if a market participant's positions exceed a speculative position limit, Calpine and other power producers may have little choice but to purchase natural gas in the spot market or restrict the variability that it provides to customers in forward contracts. Having to rely upon less flexible commercial contracts likely will make it more expensive to purchase natural gas because its supply contract would not be tailored to manage its specific commercial needs. By increasing the costs that Calpine and other power producers incur in purchasing gas to fire their plants, the Proposed Rule may increase the cost of power for consumers. The significant costs of including trade options within the definition of Referenced Contract are not offset with any discernible benefit and the Commission did not propose or otherwise explain how trade options contribute, or are related to, excessive speculation.

Calpine also notes that determining whether to categorize physical transactions as forward contracts, which are excluded from position limits, rather than trade options, is a fairly subjective process because the analysis depends upon the facts and circumstances of the transaction and the commercial needs of the parties.[7] As a result, one market participant may categorize a transaction as a forward contract and the counterparty may categorize the transaction as a trade option. Although market participants may decide to adopt a conservative approach and categorize more physical transactions as trade options for purposes of filing annual reports with the Commission on Form TO, the significant costs associated with monitoring trade options toward position limits on an intra-day basis makes a conservative approach unworkable. Given the lack of clarity surrounding the distinction between a forward contract and a trade option, Calpine requests that the Commission exclude trade options from the definition of Referenced Contract.

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[6] *See* CFTC Rule 32.3(a)(2).

[7] *See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48208 (Aug. 13, 2012).

V. The Commission Should Eliminate the Quantitative Factor for Cross-Commodity Hedges

Under the Proposed Rule, there is a rebuttable presumption that a cross-commodity hedge does not qualify as a *bona fide* hedging position if the correlation between the daily spot price series for the target commodity and the price series for the commodity underlying the derivative contract is not at least 0.80 for at least 36 months.[8] The Commission should eliminate the proposed quantitative factor from the determination of whether a cross-commodity hedge qualifies as a *bona fide* hedging position because:

- The quantitative factor places too much emphasis on the mathematical correlation of spot prices. Calpine manages a complicated portfolio of physical risks and may decide that the appropriate hedge is a liquid derivative that may not meet the Commission's 0.80 correlation analysis. For example, Calpine may hedge its forward sale of electricity by using the NYMEX Henry Hub futures contract because of the close relationship between the price of natural gas used to fire Calpine's plant and the price of electricity that the plant produces. Due to the lack of liquidity in power futures contracts, particularly farther out the forward price curve, Calpine may use the NYMEX Henry Hub futures contract as a substitute for later sales of electricity and hedge the "gas-equivalent" exposure for the plant (*i.e.*, the amount of MMBtus equal to each MW of power). These positions are risk reducing, even if the correlation between the spot prices of gas and power is less than 0.80 as described in the quantitative factor. If the Commission presumes that the hedge does not constitute a *bona fide* hedging position it will significantly reduce the risk-management tools available for Calpine to hedge its commercial risk. Calpine's natural gas Referenced Contract hedges of its electricity price risk meet the statutory definition of a *bona fide* hedging position. They plainly are not speculative positions and, therefore, should not be subject to speculative position limits.

- The proposed quantitative factor does not properly measure correlation because it only measures correlation of spot prices and does not measure correlation farther out the curve. For example, the correlation of natural gas and electricity is stronger farther out the curve compared to the spot price series. In this regard, when market participants hedge out the curve, the correlation of spot prices is not as relevant as the correlation of prices farther out the curve.

- Finally, the Commission did not provide a rationale regarding why it needed to change the existing qualitative standard for evaluating cross-commodity hedging positions.

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[8] Proposed Rule at 75717.

VI. The Commission Should Not Restrict the Ability of Market Participants to Hedge on a Gross Basis

In the Proposed Rule, the Commission suggests that hedging on a gross basis may only be appropriate "under certain circumstances, when net cash positions do not measure total risk exposure due to differences in the timing of cash commitments, the location of stocks, and differences in grades or types of the cash commodity being hedged."[9] This suggestion appears contrary to the Commission's historical approach, and the market practices that developed around it, which did not restrict the ability of a market participant to hedge on a gross basis.[10]

Calpine requests that the Commission modify the Proposed Rule to continue its long-standing practice of permitting market participants to make commercially reasonable decisions about whether and how to hedge on a gross basis and to make those determinations at a portfolio level or within a single company. As long as a company organizes portfolios of risk based on commercially reasonable risk-management principles, market participants should have the flexibility to manage risk and hedge on a portfolio level without regard to other portfolios. For example, Calpine may manage portfolios of risk by region. If it's long physical generation in one region, but short physical power in another region, its long physical position should not limit its ability to hedge its short physical position.

For Calpine and other commercial commodity companies, hedging on a net basis would be commercially impractical, requiring costly new technology systems to be built around more rigid, impractical hedging protocols that prevent dynamic risk management in response to rapidly changing market conditions. The Commission should not substitute its administrative judgment for the commercially reasonable judgment of market participants who have the responsibility of managing complex and dynamic commercial operations that incur risks from volatile commodity prices. Calpine respectfully submits that the Commission does not have, and has not articulated, a sound basis for departing from its long-standing policy of permitting market participants to hedge on a gross.

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[9] Proposed Rule at 75709. The CFTC provides an example of a market participant that enters into a fixed price sales commitment and an offsetting fixed price purchase commitment. According to the CFTC, "if such a merchant were to offset only the cash purchase contract, but not the cash sales contract (or vice versa), then it reasonably would appear the offsetting commodity derivative contract would result in an increased value exposure of the enterprise (that is, the risk of changes in the value of the cash commodity contract that was not offset is likely to be higher than the risk of changes in the value of the calendar spread difference between the nearby and deferred delivery period) and, so, the commodity derivative contract would not qualify as a *bona fide* hedge position." *Id.*

[10] *See, e.g.*, *Bona Fide Hedging Transactions or Positions*, 42 Fed. Reg. 14832, 14834 (Mar. 16, 1977) (proposed rule) ("The Commission has considered [the comments regarding 'double hedging'] and does not intend at this time to alter the provisions of the present definition with respect to the hedging of gross cash positions.").

VII. Conclusion

Calpine appreciates the opportunity to provide comments to the Commission. Calpine urges the Commission to adopt a final rule consistent with its comments and recommendations as well as the comments and recommendations of FIA and EEI/EPSA.

Respectfully submitted,

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Executive Vice President and Chief Legal Officer