February 10, 2014

Ms. Melissa Jurgens, Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Position Limits for Derivatives, RIN No. 3038-AD99

Dear Ms. Jurgens:

Through a Notice of Proposed Rulemaking published in the Federal Register on December 12, 2013,[1] the Commodity Futures Trading Commission ("CFTC" or the "Commission") has proposed speculative position limits for certain "core referenced futures contracts" and futures, options, and swaps (including trade options) deemed to be economically equivalent to such contracts (the "PL NOPR").[2] Among the core referenced futures contracts are futures contracts used to hedge price risk by companies in the oil and natural gas businesses.[3]

PAAP's Business and Interest in the NOPR

Plains All American Pipeline, L.P. ("PAAP") is engaged in the transportation, storage, terminalling, and marketing of crude oil, as well as in the processing, transportation, fractionation, storage, and marketing of natural gas liquids. PAAP owns and operates a diversified portfolio of assets that are engaged in the movement of U.S. and Canadian energy supplies which, on average, handles over 3.5 million barrels per day of crude oil and natural gas. PAAP is largely a physical logistical business, and as such is exposed to commodity price risk stemming from its marketing activities.

PAAP is a physical commercial company that uses futures, options, and swaps to manage its price risk and to procure economic delivery of crude oil and other energy commodities when appropriate. It is not a speculator. PAAP has been an active market participant for many years, and it is not aware of any risks of excessive speculation that warrant the burdens placed on commercial companies like PAAP by the regulations proposed in the PL NOPR.

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[1] *Position Limits for Derivatives*, 78 Fed. Reg. 75680 (Dec. 12, 2013).

[2] The PL NOPR proposes regulations to impose position limits on core referenced futures contracts and economically equivalent contracts pursuant to the Commodity Exchange Act ("CEA") (See 7 U.S.C. § 6a(a)(2), (5) (2013)), as the same was amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") (Public Law No. 111-203, 124 Stat. 1376 (2010)).

[3] PL NOPR at 75826 (proposed § 150.2(d) (listing four NYMEX energy commodity futures contract among the core referenced futures contracts).

As proposed in the PL NOPR, exchange-based position limits will continue to exist. In addition, federal limits will be enacted that differ in significant ways from the existing exchange limits. The federal limits will require persons to aggregate their positions with related companies,[4] track the aggregated positions in affected futures, options, swaps, and physical contracts in real-time on a futures equivalent basis,[5] comply on a real-time basis with both spot and all month position limits,[6] determine which of the contracts in the position are enumerated bona fide hedges,[7] and, if the limits are exceeded, file various forms with the Commission that provide information on cash and hedge positions.[8]

As noted above, PAAP is not aware of circumstances that require the imposition of the complex program embodied in the PL NOPR. It is clear, however, that the PL NOPR will impose burdens and compliance risk on PAAP. As explained in more detail below, the regulations proposed in the PL NOPR appear to limit PAAP's ability to hedge its risk and may deprive it of a vehicle through which it makes and takes physical delivery of crude oil.

Due to the potential negative impact of the PL NOPR on its ability to efficiently conduct its business, PAAP is filing these comments to request that the Commission limit the complexity and burden of the proposed rules and, most importantly, revise aspects of the PL NOPR that would disrupt how PAAP currently carries out its physical business.

The Scope of Bona Fide Hedges Under the Proposal Is Too Limited

PAAP currently participates in futures markets not only to hedge price risk, but also to make or take delivery of crude oil using the exchange-for-physical ("EFP") process. PAAP uses swaps and physical options for hedging purposes. PAAP currently has hedge exemptions issued by NYMEX for positions in both crude oil and natural gas futures contracts. These hedge exemptions are granted by the exchange only upon a showing that an entity is exposed to commercial risk for which the futures contract in question is a legitimate hedge. As such, PAAP has had to justify the nature of its transactions as hedges to qualify for these exemptions, and has received hedge exemptions from the exchange. PAAP understands that certain of its activities which have been recognized as legitimate hedging by the exchange would be excluded from the Commission's proposed enumerated bona fide hedges, although PAAP understands and acts in compliance with exchange rules and practices when trading futures and options.

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[4] *See Aggregation of Positions,* 78 Fed. Reg. 68946 (November 15, 2013) (Notice of proposed rulemaking).

[5] *See* PL NOPR at 75825 (proposed § 150.1, defining "Referenced contract").

[6] *See id.* at 75826 (proposed §§ 150.2(a) (Spot-month speculative position limits), 150.2(b) (Single-month and all-months-combined speculative position limits).

[7] *See id.* at 75825 (proposed § 150.1, defining "Bona fide hedging position").

[8] *See id.* at 75788 (proposed § 19.00(a)(1) (Persons filing for exemption to speculative position limits). PAAP also believes the Commission's proposed filing requirements on Form 504 for persons relying on the conditional spot month limit exemption of proposed 150.3(c) is excessively burdensome. If the positions described in proposed Section 150.3(c) are considered exempt from position limits, PAAP can see no justification for the frequency and overly broad scope of the filing to justify relying on that exemption.

Through the PL NOPR, the Commission is proposing to add an overlay of federal position limit requirements in addition to the existing exchange rules placing limits on exchange-traded positions. Before the Commission finalizes any such rules, PAAP requests that it carefully consider the burdens and complexity of its proposal and take steps, where possible, to simplify it. While the PL NOPR is aimed at those who might potentially engage in excessive speculation, the primary burdens would fall on those using the markets to hedge commercial risk. It is hedgers that will have to aggregate, categorize, and track positions against the proposed limits in real-time, and keep cash market data in the specific manner required for reporting, as well as file burdensome reports justifying bona fide hedges. All of the foregoing would be required under the proposed regulations even if a person does not engage in any speculation whatsoever (whether excessive or not).

PAAP requests that the Commission revisit the structure of its proposal to reduce the complexity and the compliance risk it poses for hedgers. The best solution to both issues would be to replace the enumerated bona fide hedge structure of the PL NOPR with a straightforward and commercially-oriented definition of bona fide hedging. Commercial companies are well aware of their commercial risks and are adept at managing them. The risks they face and the actions typically taken to mitigate those risks have been recognized by the Commission in other Dodd-Frank rulemakings as legitimate, and in PAAP's view have been properly designated as hedging for the purposes of the end-user exception regulations.[9] As noted by the Commission itself in its rulemaking on the end-user exception, only true hedging (and not transactions for the purpose of speculation) can qualify for the exception to mandatory clearing designed in the Dodd-Frank statute for legitimate hedgers.[10] The common-sense definition of hedging used for purposes of the end-user exception, and the scope of transactions covered by that definition, should also be used to define the bona fide hedges that would justify exceeding the proposed position limits. A legitimate hedge should not be excluded because it does not fall into the limited regulatory list of enumerated hedges produced by the Commission in the PL NOPR.[11]

Further, as noted above, PAAP is currently an active hedger on futures exchanges. It understands its compliance requirements and has policies in place to assure compliance. To the degree the Commission could adopt aspects of the current exchange-based approach to position limits, it would reduce the complexity and burden of its proposal. For example, the Commission could delegate to an exchange the ability to grant a hedge exemption for federal limits in conjunction with the grant of an exchange hedge exemption. Such an approach would create consistency and efficiency, and take advantage of the expertise gained by exchanges in granting hedge exemptions from position limits over many years.

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[9] *See* 17 C.F.R. § 50.50(c) (defining "hedging or mitigating commercial risk" in part as a swap position that is "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where the risks arise from . . . [t]he potential change in the value of assets that a person owns, produces, manufactures, processes, or merchandises or reasonably anticipates owning, producing, manufacturing, processing, or merchandising in the ordinary course of business of the enterprise . . . and [is not] used for a purpose that is in the nature of speculation, investing, or trading . . ").

[10] *End-User Exception to the Clearing Requirement for Swaps*, 77 Fed. Reg. 42560 at 42573 (July 19, 2012) ("[A] swap does not hedge or mitigate commercial risk if it is used for a purpose that is in the nature of 'speculation, investing, or trading.'").

[11] *See* PL NOPR at 75824 (proposed definition of "Bona fide hedging position").

If the type of hedge exemptions granted by the exchanges under the current system were used for the Commission's federal position limits (an increased limit justified by legitimate commercial risk mitigation), there would be no need for the complex enumerated hedge definitions and resulting regulatory filings proposed in the PL NOPR, and legitimate hedging that is recognized today would not be inadvertently excluded. Under such an approach, speculators would not be able to exceed position limits, and commercial hedgers would not be required to implement burdensome and expensive new systems or be subject to the compliance risk of the regime embodied in the PL NOPR.

In the event the Commission chooses to enact a final rule using the approach contained in the PL NOPR, PAAP requests that it revise the proposal as follows.

Trade Options Should Be Excluded Position Limits

In the PL NOPR, the Commission has requested comments as to whether trade option should be excluded from position limits.[12] PAAP answers that question with an unequivocal "Yes." As a physical company with a variety of commercial arrangements that include volumetric optionality, PAAP is a party to over-the-counter trade options. These contracts exist to address volumetric uncertainty inherent in physical energy commodity businesses and provide for flexibility to react to the physical realities of PAAP's business.

The trade options entered into by PAAP cannot be used for speculation. They are an integral part of the underlying cash business and are not similar to the derivatives covered by the PL NOPR. Further, they are not price discovery contracts susceptible to the potential manipulation and market abuse which the PL NOPR is intended to prevent. Simply stated, trade options are just another ingredient of a physical business, no different from other over-the-counter bilateral forward or spot transactions between commercial parties. In fact, in order to meet the definition of trade option established by the Commission, they must be physical commercial contracts of a commercial nature.[13]

Based upon their nature and lack of susceptibility to speculation, PAAP believes that physical trade options should be excluded from position limits and requests that the Commission not include them in the scope of any final rule. PAAP believes that the Commission plays an important role in the oversight of derivatives markets. However, PAAP further believes that physical commercial non-derivative contracts employed as part of the core physical business of a commercial firm should not be included in this or other aspects of the Commission's regulation.[14]

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[12] *Id.* at 75711.

[13] 17 C.F.R. § 32.3(a) (defining a trade option as a commodity option between commercial parties that is intended to be physically settled).

[14] PAAP understands and supports the Commission's regulation of derivatives markets. However, PAAP believes the Commission should tread lightly when it comes to seeking to expand such regulation to the physical commercial arrangements of a commercial company. Such activities are beyond the mission of the Commission and, as a result, its regulatory oversight. To the degree information related to commercial activities are needed to carry out the Commission's statutory duties, PAAP understands the Commission's need to obtain it. PAAP requests that any such information be limited to that clearly required to satisfy regulatory needs and that any information provided be maintained under the most restrictive confidentiality requirements available.

The Application of the Five Day Rule Should Be Clarified

PAAP believes that the application of the "five-day rule," which renders positions that would otherwise meet the proposed bona fide hedge definition not bona fide hedges when held in any physical-delivery contract during the lesser of the last five days of trading or the time period for the spot month with respect to certain of the enumerated bona fide hedges,[15] raises issues that the Commission should consider before it includes the concept in any final rule. For example, the Commission must clarify whether the five-day rule would apply to any and all positions in the physical delivery contracts, or just to those with delivery in the prompt month for purposes of the spot month limit. If the Commission's intention is the former, it should make that clear. Further, the Commission should use care when using the five-day rule to exclude any and all physical delivery contracts in the spot month period from the scope of the enumerated bona fide hedges.

The Five-Day Rule Should Not Disrupt Legitimate Hedging

Assuming the five-day rule applies only to positions in referenced contracts with delivery in the prompt month, PAAP requests that the Commission reconsider its application of the five-day rule to persons, such as PAAP, that make or take physical delivery or receipt of product under physical delivery futures contracts through the EFP process. PAAP regularly uses EFPs to make or take delivery of volumes under a NYMEX crude oil futures contract either into its storage tanks for a later sale[16] or to meet current physical sales obligations. Making or taking physical delivery under a futures contract is not speculating in the commodity. On the contrary, it is a prudent means of managing price risks while also assuring delivery of supply for a commercial physical company whose business is in the subject commodity. PAAP understands that the purpose of the five-day rule is to prevent the use of physical delivery price discovery contracts to distort expiry pricing. As the five-day rule does not extend to financially settling contracts, it should not negatively impact those undertaking purely economic hedging. It does, however, negatively impact those who can and do use physically-settled futures contracts in a manifestly physical non-speculative business to make or take delivery where financial settlement is not an adequate substitute. The Commission must ensure in any final rule that physical companies that are not using affected contracts to speculate can prudently conduct their business.

PAAP utilizes physical delivery contracts to hedge its physical price risk and provide for the receipt or delivery, if appropriate, of crude oil. When it does so, it is not engaging in excessive speculation or manipulative behavior. However, due to the application of the five-day rule, the basic hedging/supply transactions described would not qualify as bona fide hedges during the spot month period with respect to certain of the proposed enumerated bona fide hedges. As a result, they would potentially have to be unwound to avoid a risk of exceeding the Commission's

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[15] As proposed in the PL NOPR, the five-day rule would apply to: hedges of unfilled anticipated requirements, hedges of unsold production, hedges of offsetting unfixed-price cash commodity sales and purchases, hedges of anticipated royalties, hedges of services, and cross–commodity hedges. PL NOPR at 75824 (proposed § 150.1, proposed definition of "Bona fide hedging position" at (3)(iii), (4)(i), (4)(ii), (4)(iii), (4)(iv) and (5)).

[16] This was considered a bona fide hedge in the Commissions prior position limits rule (Anticipated Merchandizing Hedge), and is discussed in more detail below.

position limits. This would remove the utility of the hedge for PAAP and leave it exposed to physical price risk for the five day-rule period and supply uncertainty thereafter.

Physical-delivery futures contracts offer liquidity and transparency. The restriction of their use by way of the five-day rule would require physical companies to use the much less liquid and non-transparent forward contract market, leading to more costly and less efficient outcomes. Further, since the market for physical crude oil may dictate a change in PAAP's economic requirements, from taking physical delivery to closing out its position prior to expiry within the window covered by the five-day rule, the inability to hold physical delivery contracts will remove a valuable tool that permits either the delivery of oil or the offset of the contracts depending on market conditions. As a result, the Commission's rule, aimed at curbing excessive speculation, could end up disrupting legitimate physical business that has nothing to do with financial speculation.

PAAP therefore requests that the Commission revise the use of the five-day rule in its proposed scope of bona fide hedges, and permit physical commercial companies such as PAAP that can and do make or take physical delivery under core referenced futures contracts to be exempt from its application. PAAP would have no objection if a final rule predicated this requested relaxation of the five-day rule upon a track record of EFPs. That way, the Commission could limit a less restrictive application of the five-day rule to those for which financially settling contracts are not a viable alternative.

Additional Bona Fide Hedges Are Needed

Aside from the application of the five-day rule as discussed above, PAAP believes that restricting the definition of "bona fide hedge" to the proposed enumerated transactions does not capture many transactions that market participants like PAAP utilize to hedge commercial risk, and the Commission should expand that list to more accurately capture all hedging transactions. Certain of the following suggested enumerated bona fide hedges were requested in a petition filed with the Commission by the Working Group of Commercial Energy Firms (the "Working Group Petition"),[17] which PAAP supports.

(1) Unfilled Storage Capacity

In the PL NOPR, the Commission decided to remove one of the enumerated bona fide hedges from its previously-promulgated position limits rules.[18] That forgone exemption would have allowed as a bona fide hedge offsetting sales and purchases of commodity derivative contracts that did not exceed the amount of the same commodity that was anticipated to be merchandized, and was limited to the current or anticipated amount of unfilled storage capacity that the person owned or leased.[19] The Commission explained its removal of this enumerated bona fide hedge by stating that the value fluctuations in a calendar month spread in a commodity derivative

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[17] *Working Group of Commercial Energy Firms Petition for Commission Order Granting Exemptive Relief for Certain Bona Fide Hedging Transactions Under Section 4a(a)(7) of the Commodity Exchange Act* (Jan. 20, 2012) ("Working Group Petition").

[18] *See* PL NOPR at 75718-19 ("No Proposal of Unfilled Storage Capacity as an Anticipated Merchandizing Hedge").

[19] *See id; see also Position Limits for Futures and Swaps*, 76 Fed. Reg. 71626 at 71689 (November 18, 2011) (Final Rule) (Regulation 150.5(a)(2)(v), vacated).

contract will likely have "at best a low correlation" with value fluctuations in expected returns on unfilled storage capacity.[20]

As noted above, PAAP operates a physical business that not only merchandizes the commodity itself but also involves transportation and storage infrastructure. For example, PAAP owns tankage at Cushing, Oklahoma, the delivery location of the core referenced futures contract NYMEX Light Sweet Crude Oil (CL), as well as other storage facilities around the country. Due to its ownership of such storage, when it is economically appropriate to do so, PAAP can take physical delivery of volumes contracted through NYMEX CL positions through an EFP and store these volumes in its tanks for resale. PAAP then uses inter-month crude oil futures and options contracts to eliminate its exposure to outright commodity price changes, potentially enhance margins, and secure option premiums to ensure a minimum level of cash flow associated with these crude oil storage tanks. The use of the futures contract is directly correlated with the commercial risks of PAAP's infrastructure-based physical business that relies upon its storage assets to take delivery of supply through EFPs. PAAP is acting as an aggregator of production for crude oil producers and as a marketer of that production, using derivatives (including futures that it may take through the EFP process) to protect its margins and also ensure a minimum level of revenue generation through its marketing on behalf of its producer counterparties. In fact, PAAP is acting much as a producer would act in marketing its own production; however, under that view the five-day rule would prevent PAAP from relying on physical-delivery futures positions to hedges its price exposure in the spot month (as discussed in detail in the previous section).[21] It therefore appears to PAAP that the Commission has declined to recognize any bona fide hedge category that would permit PAAP to continue to hedge its price risk inherent in physical marketing of production utilizing its storage assets, and it requests that the Commission reconsider this considerable omission to ensure that any final rule will not impede purely physical, non-speculative commodity transactions such as those described here.

In addition, from time to time PAAP will purchase cargoes of foreign crude oil. Since the purchase of this crude oil is either directly or indirectly tied to the closing price of the NYMEX crude oil contract during the period of time the cargo is loaded, PAAP will use NYMEX crude oil futures contracts to protect its exposure to commodity prices until the cargo is physically sold by PAAP. PAAP typically stores the crude oil purchased in tankage until such time that the crude oil is delivered to a buyer. In these transactions, PAAP is able to use the NYMEX crude oil futures contract to secure a margin and eliminate its exposure to commodity price changes while the oil is stored in tankage. Similarly, the use of the futures contract is directly correlated with the commercial risks of PAAP's infrastructure-based physical business, and it relies upon its storage assets to take delivery of supply through EFPs at a fixed price.

The above scenarios represent fairly typical techniques used by PAAP to manage physical price risk arising from the purchase of physical commodities for resale using its ownership of physical storage assets. They are not speculative transactions. However, the PL NOPR would outlaw this activity to the degree the position in futures contracts exceeds the position limit.

It appears clear that the above-described storage related activities were squarely covered by the anticipated merchandizing bona fide hedge that the Commission included in its prior rule but

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[20] *See* Position Limits NOPR at 75719.

[21] *Id.* at 75824 (proposed § 150.1, definition of *Bona fide hedging position* at (4)(i).

declined to re-propose in the PL NOPR, as described above.[22] In this case, PAAP is entering into a futures contract to hedge or obtain physical supply for its storage assets from which it merchandises the commodity. This is an aspect of its physical commercial business and is not speculating.

The basis upon which the Commission determined it would not re-propose the anticipated merchandising bona fide hedge does not apply to these facts. PAAP does not look to the correlation between the futures or swap contract used to hedge a commodity to be marketed from storage and the expected returns; rather, PAAP utilizes commodity storage to house product to be marketed in future months and utilizes derivatives to reduce price risks for that commodity and to guard against unforeseen price drops. The nature of the physical energy commodity business is such that products are more profitably marketed during certain times of the year. By purchasing the commodity and storing it for marketing at a later time, PAAP can benefit from expected value increases over the course of a year.

The correlation of price movements between the contract utilized as the hedge over time and the price of the commodity in storage is not the point; rather, the derivatives contract is used to lock in a price so that PAAP will have price protection for its product in storage and thereby not lose money. Such transactions are not speculative in any sense; on the contrary, they are an integral part of the hedging required to guard against future price swings in commodities for merchants engaged in sales of those commodities. This is a common value protection strategy for physical commodity merchants, and PAAP urges the Commission to recognize this widely-used hedging strategy as a bona fide hedge and include this among any final and exclusive list of enumerated bona fide hedges.

(2) Working Group Request #3: Unpriced Physical Purchase or Sale Commitments

This requested enumerated bona fide hedge would include positions used to lock in a price differential where one leg of the underlying transaction is an unpriced commitment to buy or sell a physical energy commodity, and the offsetting physical sale or purchase has not been completed.[23]

The Commission stated that a trader has not established a definite exposure to a value change where the trader has established only an unfixed price purchase or sale obligation.[24] PAAP utilizes derivatives positions to hedge unfixed purchase or sale obligations and disagrees with the Commission that this does not establish definite exposure to value changes. There are other economic factors apart from base price of the commodity that must be taken into account in pricing a given transaction, including transportation, storage, insurance other costs. Derivative positions can help a commercial entity like PAAP lock in certain costs while still retaining price flexibility after the hedge position is established.

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[22] By contrast, the current proposed enumerated bona fide hedge at section (3)(i) of the proposed definition would cover derivatives positions hedging fixed-price sales obligations; PAAP does not always maintain a fixed-price sales obligations for the volumes at the time it hedges its purchase of those volumes in storage.

[23] *See* Working Group Petition at 6.

[24] PL NOPR at 75719.

(3) Working Group Request #7: Hedging Physical Positions Using Calendar Month Average ("CMA") Pricing

This request would include as an enumerated bona fide hedge a position held as a hedge in connection with a CMA pricing structure.

PAAP agrees with the Working Group that CMA transactions are not speculative in nature, and are utilized frequently in the energy commodities markets to hedge legitimate risk arising from commerce.[25] PAAP utilizes CMA pricing transactions frequently to hedge the commodity price risks inherent in its business.

PAAP's business involves the purchase, transportation, aggregation and sale of approximately 750,000 barrels per day of crude oil in the U.S. Among those purchase are those from producers at the wellhead at prices tied either directly or indirectly to a combination of (i) the intermonth spread between the NYMEX crude oil futures contract for the delivery month and the futures contracts for the following two months and (ii) the average of the closing prices of the NYMEX crude oil futures contract during the delivery month. This pricing is not PAAP's choice but, rather, reflects the desires of the producers and market convention. To hedge its price exposure relating to these purchase commitments, PAAP executes spread positions and/or spread option positions in NYMEX futures for a volume equal to the volume of crude oil purchased. The spread position consists of a short position in the delivery month and a long position in the following two months, approximately 2/3rds in the month following the delivery month and 1/3rd in the second month following the delivery month. PAAP executes EFP's, typically with refiners or resellers, to move the short futures position to a short physical position so that the barrels purchased from producers are delivered to refiners/resellers. The long futures positions are then unwound on a ratable basis throughout the delivery month and have the effect of matching the pricing basis of the purchases with the sales. The effect of the structure is the very real hedging of commercial risks arising from making purchases in a manner consistent with market practice and the preference of counterparties.

PAAP understands these types of hedges using CMA pricing to be within the scope of the rejected Working Group petition #7. This type of transaction is clearly a hedge of physical price risk and is not speculative in any way. PAAP is concerned that this type of hedge may not be covered by any of the proposed bona fide hedge categories enumerated by the Commission. Rejection of this activity as bona fide hedging will not impact excessive speculation. Instead, it will disrupt legitimate market activities with no corresponding discernable benefit. PAAP therefore requests that the Commission include this requested bona fide hedge category in any final set of enumerated hedges, to ensure that the final rules do not disrupt existing and legitimate hedging in connection with physical business.

[25] *See* Working Group Petition at 14.

Conclusion

PAAP requests that if the Commission enacts a final position limits rule, it assure that it permits legitimate hedging by physical commercial companies such as PAAP using a straightforward definition of hedging and without disrupting prudent risk management. Further, the Commission should assure that companies using futures contracts to make or take delivery of commodity are not prevented from properly doing so.

Respectfully Submitted,

/s/ Al Lindseth
Al Lindseth
Senior Vice President - Technology, Process and Risk Management

CC:
Acting Chairman Mark P. Wetjen
Commissioner Bart Chilton
Commissioner Scott O'Malia