BG GROUP

August 4, 2014

VIA ONLINE SUBMISSION
Ms. Melissa Jurgens
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

RE: Position Limits for Derivatives
RIN 3038-AD99

Dear Ms. Jurgens:

BG Energy Merchants, LLC ("BGEM") respectfully submits these supplemental comments regarding the Notice of Proposed Rulemaking, Position Limits for Derivatives ("Proposed Rule") issued by the Commodity Futures Trading Commission ("CFTC" or "Commission"), 78 Fed. Reg. 75680 (December 12, 2013). Pursuant to the Commission's Notice of Proposed Rulemaking, Extension of Comments Periods, 79 Fed. Reg. 37973 (July 3, 2014), BGEM limits its supplemental comments to the issues identified by the Commission and does not herein rehash its prior comments (filed February 10, 2014), which remain unmodified and unabandoned. Specifically, BGEM respectfully submits these comments primarily to address the setting of spot month limits in physical-delivery and cash-settled contracts and a conditional spot-month limit exemption.

I. Introduction

BG Group plc ("BG Group") is a global natural gas company based in the United Kingdom and a major producer and supplier of natural gas in the United States. BG Group owns natural gas producing assets in Louisiana and Texas in the area known as the Haynesville Shale and in Pennsylvania and West Virginia in the area known as the Marcellus Shale. BG Group is one of the largest suppliers of LNG to the United States and owns import capacity rights at Southern Union Company's Lake Charles, Louisiana ("Lake Charles") and El Paso Corporation's Elba Island, Georgia import terminals. BG Group also has an interest in associated liquids that are extracted from imported LNG at the Lake Charles LNG import terminal.

BG Group's subsidiary, BGEM, is a marketer of natural gas throughout certain markets in the United States and oil produced by BG Group in offshore Brazil, Kazakhstan, and the North Sea to worldwide markets. BGEM regularly engages in swaps to hedge the commercial risk associated with BG Group's production and marketing activities relating to its natural gas, liquids, and oil businesses.

II. Executive Summary

BGEM is supportive of Congress' efforts under the Dodd-Frank Act to reform over-the-counter ("OTC") swap markets in order to prevent the excessive risk taking, leverage, and market abuses that led to the financial crisis of 2008. If properly designed and implemented consistent with the authority granted to the Commission under Section 4a of the Commodity Exchange Act ("CEA"), federal speculative position limits for the Referenced Contracts identified in the Proposed Rule should not unnecessarily disrupt today's highly efficient energy markets.

However, the proposed limits are overly restrictive and will negatively impact endusers' ability to hedge commercial risk by reducing the number of counterparties available to hedgers. This loss of liquidity has already begun under the current exchange-set limits and will most certainly worsen under the proposal. Moreover, the proposed conditional spot-month limit will artificially move the remaining activity from the physically delivered futures contracts that serve as benchmarks to financially settled contracts. This will further reduce liquidity in the physically delivered futures contracts and will disrupt the price discovery function of the contracts. In short, to the extent that the Commission moves forward with federal spot-month limits, it should increase the limit levels and remove any incentives to move positions from the physically delivered futures contracts to financially settled contracts.

III. Comments

A. Setting Limits for Physical-Delivery Contracts

The Proposed Rule would establish physical spot-month limits based on 25 percent of estimated deliverable supply for the underlying commodity.[1] However, the Commission proposes to initially adopt spot-month limit levels equal to existing levels set by designated contract markets ("DCMs"). Alternatively, the Commission is considering setting the initial spot-month limit levels based on updated estimated deliverable supplies submitted by the CMEGroup. If the Commission moves forward with federal aggregate spot-month limits, it should ensure that the data upon which it bases the limits is up to date and accurately reflects all potential deliverable supply.

The existing position limit levels set by DCMs for natural gas are based on outdated deliverable supply data from 1996. As CMEGroup demonstrated in its July 1, 2013 correspondence to the Commission, natural gas supply has dramatically increased since these limits were implemented. Importantly, the fact that DCM position limits currently are in effect at the various exchanges does not mitigate the harm that would come from applying these levels to any new federal limits as the proposed limits would apply on an aggregate basis and would subject economically equivalent swaps to the same spot-month limits, whether or not they are listed for trading on a DCM or swap execution facility ("SEF"), cleared or uncleared.

[1] Proposed Rule at 75727.

BGEM is concerned that such spot-month limits are much more restrictive than what has been in place for futures traded on DCMs. Specifically, a market participant currently is permitted to carry a position of 1,000 futures equivalent on ICE and on NYMEX. However, under the Proposed Rule, a market participant would only be able to carry a combined total of 1,000 contracts on all such markets. Moreover, the Proposed Rule would add to this limit, cleared and uncleared swaps, including even physical trade options. These limits are unduly restrictive and will reduce liquidity in the energy markets, thereby impairing endusers' ability to hedge their commercial risk exposure or engage in meaningful price discovery for the affected Referenced Contract markets.

Current position limits not only are outdated but also underestimated deliverable supply even at the time they were established. For example, Bentek data used to calculate the size of the market for deliverable supply is collected from interstate natural gas pipelines and does not include intrastate sources of supply. As CMEGroup confirmed in its February 9, 2012 notification to the Commission self-certifying the listing of the Henry Hub Natural Gas Last Day Physically-Delivered futures contract, "Bentek's estimates underestimate production that can readily access the Henry Hub because we believe additional in-State production areas would not be included in Bentek's U.S. Gulf Coast estimates." (Submission 12-044) To adopt such outdated limits would only exacerbate the problem of declining liquidity in these markets.

To the extent that the Commission moves forward with federal spot-month limits, it should at a minimum rely on the alternative approach offered by the Commission to base spot-month limits on estimates of deliverable supply submitted by CME Group on July 1, 2013. These estimates more accurately reflect current data regarding deliverable supply and would increase the limits to levels that more closely resemble current aggregate levels across exchanges.

B. Setting Limits for Cash-Settled Contracts

BGEM also is concerned about setting the spot-month limit for swaps at the same level as the physically-delivered futures contracts, especially related to the natural gas market. A key factor in adopting the spot-month limit for swaps set at 25 percent of deliverable supply is the assumption that the swap or cash contract is economically equivalent to a futures position for physical delivery. BGEM agrees that, generally, in the natural gas market, due to arbitrage, a contract such as the ICE HH LD1 is in fact economically equivalent to NYMEX Henry Hub futures contract and should be aggregated for compliance with a single month and all month limit. However, during the limited window at expiry, where the spot-limit position limits are applicable, the NYMEX Henry Hub futures contract and the HH LD1 contract cease to become economically equivalent because they serve two different purposes.

Specifically, upon expiry, the HH LD1 is settled through an exchange of cash flow between the counterparties. Although this amount is determined prior to the month of delivery, no physical gas is delivered. By way of contrast, upon expiration of the NYMEX Henry Hub futures contract, in lieu of an exchange of cash flow, physical gas is

delivered over the contract month. BGEM recognizes that this analysis applies specifically to the period approaching physical delivery. However, it is the unique characteristic of delivery which causes the spot-month position limit for the physically settling futures contract to be set so low. By applying the same low spot-month limit to cash settled swaps the Commission would be dismissing not only the major differences that exist between the swaps and futures at expiry but also the much larger size of the swap market.

Global energy companies have significant price exposure to Henry Hub that needs to be hedged at levels far in excess of the physical deliverable supply at Henry Hub. Even where global energy companies may be able to qualify for hedge exemptions under the proposed rules, limits on cash-settled contracts based on the physical deliverable supply would reduce the ability of potential counterparties to accommodate the hedging needs of global energy companies. Therefore, as a result of unnecessarily restrictive position limit levels for cash-settled contracts, global energy companies may not be able to hedge their full exposure to Henry Hub.

BGEM already has seen market liquidity and its ability to hedge hindered under the weight of the existing exchange-set position limits.[2] Therefore, BGEM's concerns over setting position limit levels for cash-settled contracts at the same level as the physically-delivered futures contracts are not hypothetical. They are already playing out in the market with the current ICE and CME limits, which were approved by this Commission and put in place in October 2012 on cash-settled natural gas contracts that were converted from swaps to futures on ICE and CME. Specifically, since the conversion of swaps to futures in October 2012, exchange-set position limits have contributed to a lack of liquidity, which has become a real problem for energy companies trying to hedge. Under the current exchange-set limits, market participants have exited certain cash-settlement markets leaving producers unable to hedge risk on ICE for the next winter because the bid-ask spread is so wide that nobody is willing to transact. Spreads previously ranging about 1-2 cents have increased to over a dollar in some markets, making efficient hedging nearly impossible. At the same time, there is insufficient liquidity for market participants to establish and liquidate positions quickly during increasingly frequent price swings. For example, both TETCO M3 and Transco Zone 6 non-NY (two trading hubs in the Northeast) had significant price spikes of over a dollar this spring with less than one contract trading per day and sometimes with no trades over a two-week period. This lack of liquidity is also negatively impacting energy companies' ability to value their positions and monitor exposure for risk management purposes, because there are no longer enough transactions to identify marks at certain trading locations.[3]

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[2] *See* BGEM's February 21, 2013 "Comments on the January 31, 2013 Public Roundtable Conference on the Futurization of Swaps" (describing new position limits for all energy contracts as the most significant impact of the futurization of swaps on companies like BGEM and raising concerns regarding market liquidity for companies hedging commercial risk).

[3] "Marks" are estimates of current market value used to assess trading positions so a company can monitor its profit, loss, and risk associated with a position. When companies are unable to set a mark they may be unable to conduct

Part of the CFTC's mission under the CEA is to foster transparent, open, competitive and financially sound markets for swaps and futures. CEA Section 4a(a)(3) requires the Commission when setting position limits to "ensure that the price discovery function of the underlying market is not disrupted" and "to ensure sufficient market liquidity for bona fide hedgers."[4] Based on the foregoing, should the Commission adopt a final rule implementing position limits, it should ensure that the proposed spot-month limit level for swaps be set at a level that takes into account the size of the specific swap market itself and the overall physical market it serves, instead of a spot-month limit based on the size of the deliverable supply at the futures delivery location. BGEM also urges the Commission to publish an analysis on the size of the uncleared swap positions going to expiry.

C. Conditional Spot-Month Limit

Under the Proposed Rule, participants without a hedge exemption would be allowed to "acquire positions up to five times the spot-month limit if such positions are exclusively in cash-settled contracts and the trader does not hold or control positions in the spot-month physical-delivery referenced contract." This restriction on holding physical-delivery contracts would create a disincentive for market participants to maintain physical-delivery contracts, and, as a result, the conditional limit proposal would disrupt the price discovery function and hedging benefits of the physical-delivery contracts.

As an alternative proposal, the Commission is considering allowing this higher limit for cash-settled contracts regardless of positions held in the physical-delivery contract. For the reasons discussed below, BGEM supports this approach.

The Henry Hub natural gas price serves as a benchmark for prices of physical natural gas traded throughout the U.S. and indeed throughout North America and foreign markets. The Henry Hub price is established through the settlement process on the NYMEX. The settlement price is based upon transactions in the physically delivered futures contract executed on the NYMEX during the close. The integrity of this settlement price depends, in large part, on the volume of transactions and the variety of participants trading natural gas during this closing period.

Under the Proposed Rule, however, participants would be incentivized to get out of their physically delivered futures positions in order to access the higher spot-month cash-settled position limit. This, in turn, would draw liquidity away from the physically delivered futures contract listed on the NYMEX. Thus, if the conditional spot-month limit were to become a popular method of accessing higher cash-settled limits, the likely result would be markedly fewer participants and less liquidity in the closing period, undermining the robustness of the very process by which the benchmark settlement price is established on the NYMEX. Additionally, less liquidity and fewer participants in

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risk control processes like tracking profit, loss, and portfolio risk, which can lead to difficulty ensuring the value of the company is not misstated.

[4] CEA Section 4a(a)(2)(C) and 4a(a)(3)(B).

the physically delivered contract would create greater opportunity for manipulation of the settlement process. With the drain on liquidity and concentration of participants in the closing period, physical participants with large exposure to the NYMEX settlement price would now find it easier to influence that price, even where a participant is not intending to do so. To the extent that the CFTC is focused on minimizing the opportunities for participants to manipulate prices, BGEM encourages the CFTC to eliminate the requirement that traders hold no physical-delivery position in order to qualify for the conditional spot-month limit exemption.

At the same time that liquidity would move from the physically delivered futures contract listed on the NYMEX, the proposed conditional spot-limit would cause physical energy companies to likewise transition from physically delivered contracts to financially settled contracts. Otherwise, if an energy company held positions in the spot-month physical-delivery referenced contract, which is common for energy companies, it would be denied the higher conditional limit. As a result, there would be fewer energy companies, which trade based on market fundamentals, trading physically delivered futures contracts at levels that would help with price discovery. CEA Section 4a(a)(3) requires the Commission when setting position limits to "ensure that the price discovery function of the underlying market is not disrupted." This proposal is inconsistent with the CEA's mandate because it would decrease participation by energy companies in setting the price physically delivered futures contracts while at the same time decreasing liquidity in the products and potentially increasing the influence on price formation of other market participants who may not trade based on market fundamentals.

IV. Conclusion

BGEM appreciates this opportunity to comment and respectfully requests that the Commission consider the comments set forth herein.

Respectfully submitted,

/s/ Lisa Yoho
Lisa Yoho
Director, Regulatory Affairs
BG Energy Merchants, LLC