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August 4, 2014

To: Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Attn: Melissa Jurgens, Secretary

RE: **Comments Regarding Position Limits for Derivatives and Aggregation of Positions (RIN 3038-AD82)**

Dear Secretary Jurgens:

I. Introduction

This document is in response to the U.S. Commodities Futures Trading Commission's ("CFTC's" or "Commission's") request for public comments made pursuant to the "Position Limits for Derivatives and Aggregation of Positions" (RIN 3038-AD82) published at Page 75,680 of Volume 79 of the Federal Register (the "Proposal"). EDF Trading North America LLC ("EDFTNA") welcomes the opportunity to provide the CFTC with feedback on the proposed rulemaking amendments to 17 CFR Parts 1, 15, 17, 19, 32, 37, 38, 140, and 150.

EDFTNA is a wholly-owned indirect subsidiary of Eléctricité de France, S.A., a global leader in energy production and supply with over 140.4 Gigawatts of generation capacity and approximately 39 million customers world-wide. In addition to being the fifth largest marketer of natural gas in North America, EDFTNA is also a leading provider of energy management and risk management services and, directly and through its wholly owned subsidiaries, a provider of retail power and gas services to large-scale commercial and industrial customers.

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II. Comments

Unfilled Storage Capacity as an Anticipated Merchandising Hedge

EDFTNA request that the Commission include, as part of any final rule addressing position limits, a formal process for market participants to seek either a non-enumerated *bona fide* hedging exemption or an exemption pursuant to the Commission's general position limits exemptive authority for unfilled storage capacity that was previously vacated in §151.5(a)(2,)(v)[1], because hedges of storage capacity service is economically appropriate and reduces risk in the conduct and management of a commercial enterprise. EDFTNA request that the Commission make an exception for those circumstances when a market participant owns or leases an asset in the form of storage capacity which would provide the market participant an opportunity to establish market positions to reduce associated risk with returns anticipated from owning or leasing that capacity. Specifically, EDFTNA urges the Commission to reassess whether anticipatory merchandising transactions with regard to storage capacity meet the second "appropriateness" prong of the Commission's definition of a *bona fide* hedging transaction.[2] As noted by the Commission, there are "some circumstances, such as when a market participant owns or leases an asset in the form of storage capacity, where the market participant could establish market positions to reduce the risk associated with returns anticipated from owning or leasing that capacity."[3] A market participant who owns or leases storage capacity typically buys and sells futures of the same commodity with a larger calendar spread to hedge its storage capacity. EDFTNA appreciates the Commission's position concerning the value fluctuations in the calendar month

[1] See Position Limits for Futures and Swaps, 76 Fed. Reg. 71626, 71646-47 (Nov.18, 2011), vacated ISDA v. CFTC, 887 F. Supp. 2d 259 (D.D.C. 2012).
[2] Id at 71646
[3] Id at 71646

spread and their effect on the low correlation with the value fluctuations in expected returns, however, it is this type of market volatility that makes it crucial for a firm to have the ability to effectively and efficiently hedge such risks. By the Commission's own admission[4] the difference in the anticipated supply and demand of a commodity on different dates make the calendar month spread transactions the type of transactions that would justify a market participant who owns or leases storage capacity needing a *bona fide* hedge exemption.

EDFTNA suggests that the Commission require market participants to meet the same four conditions stated within the vacated position limits rule for recognizing anticipatory merchandising transactions as a *bona fide* hedge[5], in conjunction with the anticipatory merchandiser being required to meet the specific new filing requirements under the proposed position limits rule.[6] EDFTNA believes that these provisions, coupled with the Commission's proposed *bona fide* hedge exemption reporting requirements, are sufficient for the Commission to conduct proper monitoring and surveillance of market participant behavior while maximizing the ability of such a market participant to effectively manage and hedge its risks. Restricting the ability of a market participant who owns or leases storage capacity to engage in derivative activity to effectively and efficiently manage the risks associated with its holding of storage capacity will critically undermine its commercial enterprise and negatively impact the development of storage capacity in the US energy market.

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[4] See Position Limits for Derivatives. 78 Fed. Reg. 75718

[5] (1) The hedger owns or leases storage capacity; (2) the hedge is no larger than the amount of unfilled storage capacity currently, or the amount of reasonably anticipated unfilled storage capacity during the hedging period; (3) the hedge is in the form of a calendar spread (and utilizing a calendar spread is economically appropriate to the reduction of risk associated with the anticipated merchandising activity) with component contract months that settle in not more than twelve months; and (4) no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract for agricultural or metal contracts or during the spot month for other commodities. See 76 Fed. Reg. 71646

[6] See Position Limits for Derivatives. 78 Fed. Reg. 75680, 75831-75832

Furthermore, EDFTNA contends that such a *bona fide* hedge exemption for storage capacity can be maintained pursuant to the Commission's mandate that the trader have a reasonable certainty that he or she will engage in the anticipated merchandising activity.[7] It is reasonable for a trader to believe that the demand for natural gas will move with respect to the seasons and owners will seek to store or not store their natural gas relative to this demand. An owner or lessor of storage capacity can reasonably anticipate being exposed to unfilled capacity due to decreases in natural gas volume and storage activity. Therefore, a trader could hedge their commodity price exposure by performing an economically appropriate purchase or sale of an offsetting futures position, thereby qualifying for a *bona fide* hedge exemption. The market is well established with regard to this type of hedging strategy and therefore would support a trader's reasonable certainty that he or she will engage in the anticipated merchandising activity.

Cross Commodity Hedge using the substantially related test: Quantitative factor

The Proposed Rule introduces a qualitative and a quantitative factor to determine if a cross-commodity hedge qualifies as a *bona fide* hedging position. Under the quantitative factor the spot price of the commodity underlying the derivative and the commodity underlying the target commodity must meet a 0.80 correlation test for a time period of at least 36 months for the hedge to qualify as a bona fide hedging position.

EDFTNA is concerned that the proposed 0.80 correlation may unnecessarily constrain legitimate cross-commodity hedging. Under the Proposed Rule the Commission states that it "will presume an appropriate quantitative relationship exists when the correlation (R), between first differences or returns in daily spot price

[7] Id at 71646-71647

series for the target commodity and the price series for the commodity underlying the derivative contract (or the price series for the derivative contract used to offset risk) is at least 0.80 for a time period of at least 36 months."[8] However, under the Commission's proposed correlation formula a market participant such as a power generator is unable to effectively hedge its exposure to electricity with natural gas derivatives. Natural gas is a primary feedstock for a power generator. Power generators typically hedge their exposure to electricity prices by transacting in natural gas derivatives. Such a power generation plant wanting to reduce its exposure to electricity prices will hedge its forward prices exposure and not the commodity spot prices. EDFTNA agrees that the Commission should require market participants to show some reasonable degree of correlation with regard to cross-commodity hedging. However, EDFTNA request that the Commission consider lowering the correlation threshold and make the correlation relative to the specific commodities being cross-hedged.

As an alternative, EDFTNA suggests the Commission consider the correlation between the futures price series that expire around the same time as the hedged exposure. Evidently, correlations between commodity prices are relative and subject to several factors that could cause low or high correlations. A 0.80 correlation level for at least 36 months could serve as an appropriate measure or correlation for some cross-commodity hedge strategies but does not translate universally across all industry hedge strategies or 28 commodities in all derivatives markets. And a 36 month term may propose too long of a time period for analyzing series data versus looking at a shorter time period which would reflect a more accurate portrayal of current market conditions. Spot prices may be influenced by weather, happenstance activity which occurs at the physical site of production (e.g., a transportation pipe malfunctions or generation outage), or other additional factors. These

[8] Id at 75717

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factors, together with standard industry practices, should be taken into account when establishing correlation levels designed to achieve a substantial reduction in risk. Market conditions will inevitably change causing correlations to change as well.

Monthly reporting of bona fide hedge exemptions

EDFTNA feels that the Commission's requirements to file the "series 04 reports"[9] under the proposed reporting forms requirements is overly burdensome and would impose a substantial cost to market participants.

Under the Proposal, the Commission is expected to provide market participants with an effective response fairly quickly thereby giving the market participant a reasonable amount of time to either respond or conduct the requested market activity. However, the Proposal does not provide an indication of whether the Commission will institute a deemed acceptance provision if a market participant fails to receive a written response by the Commission within an allotted time frame. A market participant relying on a response from the Commission with regard to filed "series 04 reports" may have to reject or refuse business if it does not receive an approved exemption in advance of the offer to conduct a transaction. EDFTNA would welcome further details on how the CFTC will manage exemption requests, filed by market participants, in a way that does not disrupt the market participant's performance of efficient and timely risk management.

EDFTNA supports the Commission's decision to require risk management exemptions and request the Commission to re-evaluate the cost that these forms will impose on market participants and the potential administrative burdens that the "series 04 reports" requirements may present such as, new compliance

[9] See 78 Fed. Reg. 75680, 75788. 17 CFR Part 19

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programs, training of staff, and purchasing or modifying data management systems in order to meet and maintain the compliance requirements.

Implementation Schedule

Due to the impact and complexity of implementing such requirements as those within the Proposed Rule, EDFTNA request that the Commission provide market participants with more than the statutory minimum of 60 days to come into compliance once the Proposal has been finalized.

If you have any questions regarding our response please do not hesitate to contact me.

Respectfully submitted,

/s/ Paige J. Lockett

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