March 30, 2015

<u>Via Electronic Submission</u>

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

Re: Position Limits for Derivatives (RIN 3038-AD82)

Dear Mr. Kirkpatrick:

The Electric Power Supply Association ("EPSA") appreciates the opportunity to provide the Commodity Futures Trading Commission ("CFTC" or "Commission") with limited comments set forth below in response to the Commission's extension of the comment period[1] on the Notice of Proposed Rulemaking concerning Position Limits on Derivatives ("NOPR" or "Proposed Rule")[2] following the Energy and Environmental Markets Advisory Committee ("EEMAC") meeting on February 26, 2015. EPSA and its members have been active participants in the Commission's numerous rulemakings implementing the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), including submitting comments on prior position limits rules issued by the Commission.[3]

I. Description of EPSA and Its Interest in the Proposed Rule

EPSA is the national trade association representing leading competitive power suppliers, including generators and marketers. These suppliers, who account for nearly 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities. EPSA seeks to bring the benefits of competition to all power customers.

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1 Position Limits for Derivatives and Aggregation of Positions, 79 Fed. Reg. 30,762 (May 29, 2014).

2 Position Limits for Derivatives, 78 Fed. Reg. 75,680 (Dec. 12, 2013).

3 *See, e.g.*, Letter from EEI and EPSA to David Stawick, Sec'y, CFTC (Mar. 28, 2011) (on file with the CFTC); Letter from EEI to David Stawick, Sec'y, CFTC (Jan. 17, 2012) (on file with the CFTC); Letter from EEI, AGA, and EPSA to David Stawick, Sec'y, CFTC (Mar. 1, 2012) (on file with the CFTC); Letter from EPSA and EEI to Melissa Jurgens, Sec'y, CFTC (Feb. 7, 2014).

EPSA members are physical commodity market participants that rely on referenced contracts to hedge and mitigate their commercial risk. Regulations that make effective risk management options more costly for end users of derivatives will likely result in higher and more volatile energy prices for retail, commercial, and industrial customers. As end users of commodity derivatives who hedge commercial risk, EPSA's members have a direct and significant interest in the Commission's proposal to establish speculative position limits.

II. Background and Procedural History

On December 12, 2013 the Commission published a NOPR to establish speculative position limits for 28 exempt and agricultural commodity futures and option contracts and physical commodity swaps that are "economically equivalent" to such contracts. Comments on the NOPR were due February 10, 2014. EPSA, jointly with the Edison Electric Institute ("EEI") filed comments in response to the NOPR. On June 19, 2014, the Commission held a public roundtable to discuss and consider certain issues related to the Proposed Rule regarding position limits for physical commodity derivatives. The Commission reopened the comment period on the Proposed Rule starting on June 12, 2014 and ending on August 4, 2014.[4] The Commission re-opened the comment period again in response to the Agricultural Advisory Committee meeting in January and the EEMAC meeting on February 26, 2015. The latest comments are due in response to the issues discussed at the EEMAC meeting no later than March 28, 2015.

EPSA appreciates the Commission hosting the EEMAC meeting and reopening the comment period to allow for comments related to the discussions at the meeting. While many of the points raised at the EEMAC meeting echo points raised in EPSA's prior comments filed, we will not rehash each point here. Rather, we would like to take this opportunity to reiterate a few key points raised at the EEMAC meeting.

III. Comments

A. *The Commission Should Evaluate and Update the Information and Data Used to Establish Position Limits Including Deliverable Supply and Spot Month Limits*

As stated in earlier comments, EPSA encourages the Commission to look at how deliverable supply is currently determined and update that information for purposes of re-establishing and evaluating any proposed position limits. In addition to these comments, EPSA is joining with the ICE on comments requesting updated estimates of deliverable supply based on alternative methods from those currently used and proposed by the Commission. We refer to that letter as comment on the need for updated deliverable supply data for appropriate position limits regulations.

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[4] 79 Fed. Reg. 37973 (July 3, 2014).

B. *The Commission Should Consider Market Participant's Expertise and Commercial Risk Management Activity In Establishing Position Limits and Exemptions*

EPSA members are physical commodity market participants that rely on commodity derivative contracts primarily to hedge and mitigate their commercial risk. If the Commission adopts a Final Rule that is too narrow or inflexible, including an unworkable definition of *bona fide* hedging, it will make important hedging activities more difficult for commercial end users which, as a consequence, will likely increase the volatility and price of energy for residential, commercial, and industrial customers. Accordingly, EPSA urges the Commission to give careful consideration to the extensive experience market participants, including EPSA members, bring to bear and the extensive comments submitted throughout the Position Limits Rulemaking process. EPSA stresses the importance of adopting and implementing a Final Rule that is easily understandable, commercially practicable, and does not hinder the ability of market participants to effectively manage risk.

As previously explained, utilities and other power generators, including EPSA members, have long used natural gas futures contracts to hedge the price risk associated with electricity production. This hedging activity is a successful risk-management practice that has been employed for decades based upon EPSA members' commercial experience and reasonable business judgment. However, the Commission stated in the Proposed Rule that fluctuations in the value of electricity contracts are not considered substantially related to fluctuations in the value of natural gas.[5] EPSA disputes this determination and requests that the Commission should not attempt to substitute its administrative judgment for the commercially reasonable business judgment of market participants.

Contrary to the Commission's stated belief about the correlation between power and natural gas prices, there is substantial evidence in the assessments done by the Federal Energy Regulatory Commission ("FERC") as well as the system operators responsible for maintaining reliability in the electricity markets about the correlation between electricity contracts and natural gas contacts.[6] In fact, electricity prices and natural gas prices are so interrelated that the FERC recently initiated a rulemaking process[7] and an administrative docket to evaluate the correlation

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[5] *Id.*

[6] *See e.g.* Winter 2013 -14 Energy Market Assessment, FERC Staff Report to the Commission (slide 11 illustrates correlation between natural gas and electricity prices in New England); 2013 Special Reliability Assessment: Accommodating an Increased Dependence on Natural Gas for Electric Power http://www.nerc.com/pa/RAPA/ra/Reliability%20Assessments%20DL/NERC_PhaseII_FINAL.pdf; Coordination Between Natural Gas and Electricity Markets , AD12-12 FERC Staff Quarterly Reports, http://www.ferc.gov/legal/staff-reports/2013/A-4-presentation.pdf;; Potomac Economics 20121 State of the Market Report for the ERCOT Wholesale Electricity Markets, http://www.potomaceconomics.com/uploads/ercot_reports/2012_ERCOT_SOM_REPORT.pdf; ISO New England 2013 Regional Electricity Outlook, http://www.iso-ne.com/aboutiso/fin/annl_reports/2000/2013_reo.pdf;

[7] *Coordination of the Scheduling Processes of Interstate Natural Gas Pipelines and Public Utilities*, 79 Fed. Reg. 18,223 (April 1, 2014).

between the two markets and direct the natural gas markets and the electricity markets to work together to ensure greater coordination between the two markets.[8] The Proposed Rule would inappropriately limit a necessary, well-established, and beneficial hedging practice. EPSA is concerned that the Commission will reduce a complex, and often subjective, process to a flawed mathematical formula which will inappropriately eliminate the best available hedge.

C. *The Commission Should Not Regulate Exempt Commodity Trade Options As Referenced Contracts*

As noted at the EEMAC meeting, EPSA reiterates that commodity trade options should be excluded from the definition of "Referenced Contract" [9] and, thus, exempt from the Position Limits rules. As currently drafted, the proposed definition of "Referenced Contract" would include commodity trade options. While commodity trade options technically fall within the definition of a "swap", such transactions are generally exempt from regulation under Part 32 of the CFTC's rules because they are entered into by commercial market participants and, if exercised, would result in the sale of a physical commodity for immediate or deferred shipment or delivery.[10] Trade options must be transacted by commercial market participants as part of their commercial businesses. EPSA notes that a trade option is not a speculative derivative and cannot give rise to excessive speculation.

EPSA previously urged the Commission to exclude from the definition of Referenced Contract commodity trade options that are exempt under Part 32 explaining that subjecting commodity trade options to position limits would impose a complex and expensive new regulatory regime on a category of non-speculative commercial transactions (and in many cases, commercial market participants) that have never been subject to position limits set by the CFTC or any other financial regulator.[11] Position limits are established limits for speculative positions, and the CFTC has previously recognized that Commodity Trade Options are not for speculative

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[8] *Winter 2013-2014 Operations and Market Performance in Regional Transmission Organization and Independent System Operators*, Docket No. AD14-8-000.

[9] Under the Proposed Rule, all Referenced Contracts, as defined in proposed regulation 150.1, will be subject to the Position Limits Final Rule.

[10] Proposed Rule at 75,711 ("the position limit requirements proposed herein still would be applicable to trade options qualifying under the exemption").

[11] This is particularly true for commercial market participants that enter into forward contracts with embedded optionality. Due to regulatory uncertainty over whether certain contracts with embedded optionality are swaps or excluded forward contracts, many market participants have, out of an abundance of caution, characterized their agreements as commodity trade options in order to reduce the risk that these forward contracts would be deemed in hindsight to be swaps and, therefore, subject to extensive regulatory requirements. Subjecting otherwise exempt commodity trade options to position limits makes this safe harbor much less viable for many market participants.

purposes.[12] Commodity trade options provide a mechanism for merchandisers to sell future production, and for consumers to purchase a physical commodity. Trade options can have longer, multi-year terms, and embedded volumetric optionality. If trade options are subject to position limits, one long-term trade option could inappropriately use up the majority of a market participant's [speculative] trading limits for multiple years. Moreover, the CFTC expressly recognized the importance of agreements that contain embedded optionality when it recognized that "supply and demand requirements cannot always be accurately predicted" and that embedded volumetric optionality can be a "commercially reasonable way to address [such] uncertainty."[13] Given that the Commission has expressly asserted that trade options are non-speculative and has described explicitly an exempt trade option as a transaction entered into "solely for non-speculative purposes demonstrably related to [the offeree's] commercial business in the commodity which is the subject of the option transaction," EPSA urges the Commission to exclude from the definition of Reference Contract commodity trade options.

Additionally, since there are still outstanding requests for clarification on the treatment of physical forward contracts with embedded volumetric optionality, EPSA reiterates our request for clarification and reasserts that commodity trade options should be exempt from the position limits rules.

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12 *Regulation of Commodity Option Transactions*, 43 Fed. Reg. 54220, 54221 (November 21, 1978); *see also Proposed Reissuance of and Amendments to Regulations Permitting the Grant, Offer and Sale of Option on Physical Commodities*, 46 Fed. Reg. 23469, 23476 (April 27, 1981).

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

IV. Conclusion

EPSA appreciates the Commission's continued consideration of industry participants' input regarding development and implementation of Position Limits Rules and on the Proposed Rule. For the foregoing reasons, EPSA respectfully requests that the Commission adopt its comments and allow its members to continue to operate in a commercially reasonable manner to manage their risk in the commodities markets.

Please contact us at the number listed below if you have any questions regarding these comments.

Respectfully submitted,

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