BG GROUP

March 30, 2015

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 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, 80 Fed. Reg. 10022 (February 25, 2015), BGEM limits its supplemental comments primarily to the issues discussed during the Energy and Environmental Markets Advisory Committee meeting on February 26, 2015 ("Round Table").

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 liquefied natural gas ("LNG") to the United States and owns import capacity rights at Energy Transfer Partners, L.P.'s Lake Charles, Louisiana ("Lake Charles") and Kinder Morgan Inc.'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 is a marketer of 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, LNG, and oil businesses.

II. Comments

A. What does the data show?

1. One size does not fit all.

The Proposed Rule would create a single position limit regime across all futures and swaps markets, but it is clear from the data that all markets are not the same. Energy markets are different. Commenters have consistently highlighted differences between energy markets and other markets, and the Round Table discussion supported these claims with data.

As Erik Haas of ICE Futures U.S. highlighted in his presentation during the first panel discussion, energy markets are quantitatively different from agricultural markets. Specifically, the open interest, forward curve comparison provided by Mr. Haas for power and gas, as compared to sugar and cotton, showed greater open interest for the energy contracts. The greater demand for liquidity for *bona fide* hedgers in the forward curve for energy commodities illustrates the importance of preserving liquidity in these forward markets. BGEM is concerned that the Proposed Rule will degrade liquidity in the forward curve by imposing prescribed any/all month position limits and eliminating the ability of commercial market participants to enter into long-standing hedging transactions.

The Commission can address differences among the markets it regulates either by (i) developing federal position limit rules that differ across markets; (ii) adopting rules that are broad enough and/or limited enough to address the unique concerns of each market; (iii) continuing the successful principle-based approach of relying on exchanges to act as self-regulatory organizations to tailor and implement rules in the discrete markets for which they offer contracts; or (iv) some combination of the above. Relying on self-regulatory organizations to fulfill their roles as regulators will protect energy markets from overly restrictive limits that threaten liquidity, price discovery, and commercial participants' ability to hedge.

2. Excessive speculation is not a problem in energy markets.

The data also indicates that excessive speculation is not a problem in energy markets. Based on the data provided by Mr. Haas regarding convergence, the Henry Hub and Dominion South Basis Futures Contracts appear to be operating as effective price discovery contracts.[1] In fact, judging from the Round Table discussion, the problem appears to be that there are too few traders in the market; therefore, liquidity is in jeopardy, impairing the ability to hedge further out the forward curve. Therefore, the first priority of the Commission should be to promote liquidity in energy markets. If the Commission concludes that Congress mandated new federal position limits for energy markets, then it should proceed with caution and consider ways to reduce the burden of position limits and promote participation in futures markets.

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[1] *See* Panel I, Erik Haas On behalf of ICE Futures U.S., Energy and Environmental Markets Advisory Committee Meeting February 26, 2015, *available at* http://www.cftc.gov/PressRoom/Events/opaevent_eemac022615.

3. Any final rule should be limited to a federally mandated spot-month limit (not any/all month limits).

Any final rule should continue to delegate to designated contract markets ("DCMs") authority to maintain position accountability regimes and should not impose hard position limits outside of the spot month. The DCMs' use of accountability levels provides the flexibility necessary to assess risks to the market on a case-by-case basis and to manage those risks without unduly restricting parties' ability to participate in the forward market. Not only has this system proven successful over an extended period, there is no evidence in the record of excessive speculation in the forward market. Rather, there is evidence of insufficient liquidity, which results in limited price discovery and an inability for commercial participants to hedge efficiently.

While the Commission's public data on unique persons holding positions over the levels of the proposed limits (Table 11 and Table 11a)[2] suggest that relatively few would have been over the proposed any/all month limits for NYMEX Henry Hub Natural Gas, this data is incomplete and may be misleading. As important as the number of unique persons that would have exceeded the proposed limits is the number of contracts above the proposed limits and the distribution of those contracts on the forward curve. While ICE reported approximately 200 unique participants in the March contract as of February 20, 2015, the number drops substantially as we move out the forward curve, dropping below 50 just beyond three years and ultimately to single digits. Losing a single counterparty in the outer months, let alone up to three counterparties, is not immaterial. Further, without knowing the volume that would have been eliminated, it is not possible to assess the full impact of the limits.

Participants in the Round Table raised another important point that most industry participants will hedge in one direction and need speculators in the market to take the opposite position. Therefore, it is important to allow sufficient speculative transactions in any/all month periods to promote liquidity for *bona fide* hedgers. Authorizing DCMs to promote liquidity through the management of accountability levels for any/all month positions will enable them to take into consideration the need to allow for speculative activity in periods of insufficient liquidity and, at the same time, to clamp down on speculative activity if excessive speculation were to become a concern.

Importantly, even if the data behind Table 11 and Table 11a were to demonstrate that few would be impacted and that the volume affected would be small, this would not justify the Proposed Rule. In fact, it is evident that there is no need for any/all month position limits. Were there excessive speculation in natural gas, and were any/all month limits to be the remedy, we would expect that the Proposed Rule would have material impacts. However, Table 11 and Table 11a appear to be intended to comfort market participants that the impacts are immaterial. If, in fact, the impact of the Proposed Rule is immaterial, but it threatens already fragile liquidity, the cost greatly outweighs the intended benefit.

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[2] In the Proposed Rule, the Commission included Table 11, which set forth "Unique Persons Over Percentages of Proposed Position Limit Levels, January 1, 2011, to December 31, 2012." Proposed Rule at 75731. In its recent notice extending the comment period for the Proposed Rule, the Commission also included Table 11a, an updated version of Table 11, based on counts from the period of January 1, 2013 to December 31, 2014. 80 Fed. Reg. 10022 at 10024-26.

4. Trade options should be excluded from position limits.

There was consensus at the Round Table that trade options should not be subject to position limits. All who discussed trade options agreed that it is impractical and likely impossible to convert trade options into futures-equivalent quantities in a meaningful way. BGEM agrees with the consensus view, reiterates its support for that position, and urges the Commission to make clear in any final rule that trade options are not subject to any limits imposed.

Volumetric optionality is common in natural gas markets. For example, a producer or marketer may agree to sell to an end-user up to a maximum amount of natural gas at either a fixed price or an index price, subject to the end-user nominating the gas on a daily, weekly, or monthly basis. Likewise, an end-user or marketer may agree to buy from a producer up to a maximum amount of natural gas subject to the producer nominating the amount to be delivered. Under the Commission's swap definition and related interpretations, this optionality, when absolute (*i.e.*, when one party can elect to require delivery between a range from zero to a maximum amount), can turn a physical, forward natural gas contract into a trade option.

It is important to clarify one point regarding trade options. In the order adopting the interim final rule on trade options, the Commission explained "[t]rade options, which are commonly used as hedging instruments or in connection with some commercial function, would normally qualify as hedges, exempt from the speculative position limit rules."[3] However, in some instances, a trade option may not qualify as a *bona fide* hedge because trade options are physical supply arrangements that are often intended to mitigate supply risk more than price risk. The party with no right to exercise the option has created a commitment as opposed to necessarily offsetting a liability. Further, the party with the right to exercise the option may or may not use the trade option to hedge a fixed-price exposure.

B. Experience with position limits and trading liquidity.

As a commercial market participant, BGEM has a vested interest in robust markets that give it an opportunity to hedge commercial risk and that provide accurate price discovery. Liquidity is vital to hedging and price discovery, and a lack of liquidity has become an increasingly common problem in U.S. natural gas markets. Any threat to liquidity is of great concern and should be weighed heavily against any purported benefit from the Proposed Rule.

1. BGEM's experience is that liquidity is already a problem.

End-user participants at the Round Table consistently raised concerns that the Proposed Rule will reduce liquidity and reported that, in fact, liquidity has already declined today. As BGEM has noted in prior comments, existing exchange-set limits may already have negatively impacted liquidity.

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[3] Commodity Options, 77 Fed. Reg. 25320, 25328 n.50 (Apr. 27, 2012) (Final Rule).

Following the conversion of ICE-cleared swaps contracts to cash-settled futures contracts, the contracts became subject to exchange-set limits. Since that conversion, market participants have exited certain cash-settlement markets, impairing producers' ability to hedge commodity risk because the bid-ask spreads became too wide. Market participants are finding it difficult to hedge their Henry Hub exposure beyond six months forward because bid-ask spreads are too wide due to lack of liquidity down the forward curve. This lack of liquidity has made it difficult for market participants not only to establish positions, but also to liquidate positions quickly, and has reduced the level of price discovery in these markets.

Considering liquidity is a growing concern in U.S. energy markets, any rule that presents a threat to liquidity, particularly in lightly traded forward markets, should be considered with caution.

2. The Commission's own data suggests there would be a negative impact on trading liquidity.

The data provided in Table 11 and Table 11a raises concerns and, at a minimum, does not support adoption of the Proposed Rule. Table 11 and Table 11a show that 83 unique persons exceeded the proposed spot-month limits in physically-settled contracts (2013 – 2014) and 187 exceeded the proposed limits in cash-settled contracts. These are not immaterial numbers. During the Round Table, Mr. Haas of ICE reported that only 200 unique participants held positions in the March contract as of February 20, 2015 (at the height of participation and just two business days before the prompt month).

Importantly, to mitigate the risk of violating hard position limits, companies often set internal limits that are below the limits established by regulation. This means even companies that would not have exceeded the limits during the period of review may have changed their behavior and reduced their willingness to transact if the proposed limits were in effect. Moreover, the more burdensome the exemption process or reporting requirements for hedge exemptions, the greater the likelihood that market participants will limit their activities even where a hedge exemption is appropriate in an effort to avoid the burden. It is likely, therefore, that the more meaningful data from Table 11 and Table 11a may be the number of unique persons impacted at 80% of the proposed level. In any event, the number of unique persons, while important, is less meaningful a number than the volume impacted and the distribution on the curve of that volume.

3. Financially-settled limits should not be based on deliverable supply.

BGEM previously has raised concerns with calculating limits for cash-settled positions based on physical deliverable supply. There continues to be no rational basis for limiting financially-settled positions based on physical deliverable supply. For physical delivery contracts, there is no justification for basing position limits on deliverable supply data that will be two decades old when limits are imposed. Therefore, BGEM maintains and incorporates by reference its prior comments related to these issues.[4]

[4] *See* BGEM, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99, 2-5 (Aug. 4, 2014) ("BGEM August Comments"); BGEM, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99, 6 (Feb. 10, 2014) ("BGEM February Comments").

C. *Bona fide* hedging.

1. Bona fide hedges should not be limited to enumerated hedges.

Bona fide hedges should not be limited to a finite set of enumerated hedges. As was immediately apparent during the Round Table discussions, there currently are too many examples of transactions in energy markets that are prudently undertaken and economically appropriate to mitigate risk to regulate by enumeration. Even were the Commission to identify every appropriate hedge in the market today, there remain countless scenarios to be discovered in the future.

Although BGEM appreciates the potential concern that speculators may abuse the *bona fide* hedge exemption, there is no evidence in the record that this is a real threat, especially in energy markets. Moreover, the Commission has ample enforcement authority to deter and punish market participants for misrepresentations and for disruptive trade practices. In light of the significant risk to *bona fide* hedging and the statutory obligation to exempt *bona fide* hedges from position limits, the Commission should retain flexibility in its definition of *bona fide* hedging and rely on DCMs to assess hedges and carry out oversight and enforcement where appropriate.[5]

2. The enumerated hedges should be expanded.

Even if the Commission appropriately elects to restore flexibility to the definition of *bona fide* hedging and/or to provide a mechanism for approval of non-enumerated hedges, it is important that it address the specific examples raised in comments to date. While the examples posed to date are not exhaustive, they are common examples of prudent risk management practices and the Commission should not leave market participants with any doubt as to their qualification as *bona fide* hedges.

With regard to the examples discussed during the Round Table, BGEM echoes the panelists' view that the exemptions described by Ronald Oppenheimer should qualify as *bona fide* hedging. Mr. Oppenheimer's example of a buy or sell of physical gasoil at a floating price is equally applicable to the global LNG market, for which pricing exposure is often linked to Henry Hub.[6] Similarly, Mr. Oppenheimer's example of a winter storage transaction also should qualify as a *bona fide* hedge for the reasons articulated during the Round Table.[7]

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[5] Specifically, the Commission should retain the "but not limited to" clause currently included in 1.3(z) of the Commission's regulations. CFTC Rule 1.3(z)("The definitions of *bona fide* hedging transactions and positions in paragraph (z)(1) of this section includes, but is not limited to, the following specific transactions and positions").

[6] *See* Illustrative Hedging Examples, Ronald S. Oppenheimer On behalf of The Commercial Energy Working Group, Energy and Environmental Markets Advisory Committee Meeting February 26, 2015, *available at* http://www.cftc.gov/PressRoom/Events/opaevent_eemac022615.

[7] *Id.*

3. The quantitative factor for cross-commodity hedging should be removed.

Cross-commodity hedging is a significant concern to BGEM. The Commission's proposed quantitative factor will significantly impair the ability of market participants to hedge risk such as using natural gas futures contracts to hedge power. While BGEM does not transact in power markets, many of its customers do, as do many participants in natural gas derivatives markets. Any barriers to hedging electricity using natural gas futures would not only inhibit the ability of power generators, marketers, and consumers to hedge their risk, but it also would further erode liquidity in natural gas markets.

4. The Proposed Rule imposes unnecessary burdens on end-users and discourages participation and innovation by commercial hedgers.

It was again clear during the Round Table discussion that it will be critically important to make any position limit regime flexible with regard to transactions that can qualify as *bona fide* hedging. A key component of any successful system will be expediency.

a. Procedural flexibility and agility are required for bona fide hedgers.

As noted during the Round Table, any process that requires market participants to petition the Commission for a non-enumerated hedge exemption will not be effective. It is unlikely that such a process would be practical for market participants managing risk in real-time. Rather, a self-executing and generalized definition of "*bona fide* hedge" is needed to ensure that market participants can confidently and expediently determine that a given position will or will not qualify as a *bona fide* hedge.

One resource available to the Commission to implement position limits is the exchanges. The exchanges have proven effective at reviewing and granting hedge exemptions under which they take into account the individual portfolio risks of companies at the time of the detailed application process. Moreover, because the exchanges will continue to apply their own position limits, accountability levels, and exemptions under the Proposed Rule, delegating authority for federal exemptions also would reduce duplicative regulation. The exchanges have experience regulating these markets and are in a better position to assess and react to exemptions arising from changes in positions and market conditions in real-time. If the Commission were to allow the exchanges to continue to grant hedge exemptions in a manner consistent with the current process under final position limits rules, it would reduce the burden on the Commission and on commercial hedgers to seek exemptions from the relevant exchanges.

One way to achieve this outcome is to preserve the language of current rule 1.3(z)(3) and authorize exchanges to make the initial determination as to whether a position qualifies as a *bona fide* hedge. To the extent that the exchange recognizes the position as a hedge, it would not count toward the exchange or the federal position limits. At any time, the Commission can review an exchange decision or provide additional guidance as needed to prevent excessive

hedge exemptions.[8] In this way, the Commission could maintain oversight, but push the frontline responsibility to the self-regulating organizations as it does with other market surveillance and enforcement responsibilities.

b. Reporting and other burdens associated with hedging should be minimized.

Finally, as proposed, the process for reporting enumerated *bona fide* hedges is overly burdensome and complicated for end-users who are hedging their commercial risk. It is a long-standing practice for BGEM, like many end-users in the gas markets, to hedge risk on a portfolio basis as opposed hedging on a one-to-one basis. Although the Commission proposed to allow market participants to hedge risk on a portfolio basis, the proposed Form 204 and Form 704 require market participants to report activity that serves as the basis for a *bona fide* hedge separately by each enumerated hedge. By requiring BGEM and other end-users to report hedges based on the type of enumerated hedge, the proposed forms will require BGEM to significantly modify its long-standing hedging practice. BGEM recommends that the Commission modify the proposed forms to better reflect the concept of portfolio hedging and not require market participants to separately report each individual enumerated hedge.

III. 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

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[8] If the Commission disagrees with an exchange hedge exemption after the fact, it should provide the applicant with an opportunity to reduce its position without the risk of a position limits violation.