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15000 Commerce Parkway, Suite C
Mt. Laurel, NJ 08054

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Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
Telefacsimile: (202) 418-5521
Email to secretary@cftc.gov and electronically to http://comments.cftc.gov

Re: Comments of the International Energy Credit Association with respect to the CFTC's Re-Opened Comment Period for its Proposed "Position Limits for Derivatives and Aggregation of Positions," 80 Fed.Reg. 10022 (February 25, 2015), as corrected 80 Fed.Reg. 15699 (March 25, 2015), RIN 3038-AD99; and RIN 3038-AD82

Dear Mr. Kirkpatrick:

On February 10, 2014, the International Energy Credit Association ("IECA") submitted written comments ("Initial PL Comments") to the Commodity Futures Trading Commission ("Commission" or "CFTC") with respect to the CFTC's proposed rule on Position Limits for Derivatives, published on December 12, 2013, RIN 3038-AD99 ("Position Limits Proposal"). On August 4, 2014, the IECA submitted additional comments ("Roundtable Comments") to the CFTC with respect to the CFTC's proposed Aggregation of Positions, published on November 15, 2013, RIN 3038-AD82 ("Aggregation Proposal"), and the above-named Position Limits Proposal, RIN 3038-AD99, when the comment period was re-opened following the CFTC Staff's Position Limits Roundtable held on June 19, 2014.

After the meeting of the CFTC's Energy and Environmental Markets Advisory Committee on February 26, 2015 ("EEMAC Meeting"), the Commission again reopened the comment period on the Position Limits Proposal and the Aggregation Proposal, as described in the above caption, with comments to be submitted no later than March 30, 2015. The IECA is pleased to submit the comments set forth herein ("Comments") in response to this reopening of the comment period following the EEMAC Meeting.

Following the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("DFA") and its amendments of the Commodity Exchange Act ("CEA"), the IECA has filed numerous comments with the Commission seeking to protect the rights and advance the interests of the commercial end-user community that makes up the majority of its membership. Most of the IECA's members are representatives of commercial end-users that rely on swaps to help them mitigate and manage (i.e., hedge) the risks of energy commodity price volatility to their physical energy businesses.

Correspondence with respect to these comments should be directed to the following individuals:

Zackary Starbird
First Vice President
International Energy Credit Association
30 S. Wacker Drive, Suite 900
Chicago, IL 60606
Phone: 312-594-7238
Email: zack.starbird@bp.com

Phillip G. Lookadoo, Esq.
Haynes and Boone, LLP
800 17th Street, NW
Suite 500
Washington, DC 20006
Phone: 202-654-4510
Email: phil.lookadoo@haynesboone.com

I. IECA Reiterates Certain Fundamental Points Made in its Initial PL Comments and its Roundtable Comments Regarding the Position Limits Proposal and the Aggregation Proposal.

A. Position Limits Should Limit Excessive Speculation Not Hedging

First and foremost, CEA Section 4a(c)(1) makes clear: "**No rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions or positions** as such terms shall be defined by the Commission by rule, regulation, or order consistent with the purposes of this chapter." The "undue and unnecessary burden on interstate commerce in [a] commodity" that the CFTC is directed to "diminish, eliminate or prevent" is NOT hedging.

As was shown by various examples at the EEMAC Meeting, several energy companies provided specific examples of legitimate transactions, that were intended to "hedge their legitimate anticipated business needs," but which were not included in the Commission's list of hedges "enumerated in paragraphs (3), (4) or (5)" of the definition of "Bona fide hedging position" in proposed CFTC Regulation 150.1.

In fact, limiting the hedging strategy of producers, purchasers, sellers, middlemen, and users of a commodity or a product derived therefrom to nothing more than an enumerated list of bona fide hedges will continuously prohibit and limit legitimate, bona fide hedging strategies by commercial end-users and will stifle innovative ways of mitigating commercial risk. Limiting the hedging strategies of business people at a commercial end-user to only those enumerated examples that can be envisioned by a governmental regulator, almost by definition, puts an "undue and unnecessary burden" on the ability of commercial end-users to hedge their exposure to the risk of adverse commodity price volatility. Surely, that cannot be what was intended by Congress when it enacted CEA Section 4a(c)(1) to say "No rule, regulation, or order issued under

subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions or positions"?

On this basis, the IECA submits that the Commission's definition of "bona fide hedging position" in the Position Limits Proposal, which imposes such limits is simply contrary to the requirements of CEA Section 4a(c)(1) and (2). **See Part II of these Comments for our suggested alternate means of fulfilling the Commission's obligations under CEA Section 4a(c)(2) without prohibiting truly legitimate (bona fide) hedging transactions by producers, purchasers, sellers, middlemen and users of a commodity.**

B. Deliverable Supply Determination

IECA requests that the CFTC make a determination as to the deliverable supply estimates for each of the 28 physical commodities covered by the Position Limits Proposal that will serve as the baseline for spot month position limits. Until a proper deliverable supply baseline is established, it will be impossible to assess the appropriate long or short spot month limits that may be set for individual contract markets.

The Commission has received updated deliverable supply data from affected contract markets which we believe are very conservative estimates. We urge the Commission to make an objective economic study of the relevant physical commodities that could be delivered to satisfy relevant contracts upon expiry. As an example, in light of the vast amount of domestic crude production that occurs in the United States as well as the amount of historic import activity, we believe that deliverable supply calculations should include oil production and import capacity beyond merely referencing storage tankage in Cushing, Oklahoma as the only level of "deliverable supply" for the WTI contract.

Additionally, we encourage the Commission to analyze physical markets in an objective fashion that is appropriate for each different commodity asset class. As referenced above, the CFTC may consider domestic storage capacity, real time production levels and historic import activity for asset classes such as oil and gas but the Commission must also consider generation capacity of power plants or refinery capacity across the United States when contemplating deliverable supply levels for electricity or gasoline as such commodity asset classes are not storable (electricity) or are manufactured in a dynamic fashion (gasoline).

Once the CFTC makes its determinations as to the physical deliverable supply estimates, it should also take into consideration an additional indicia of deliverable supply - historic swap activity - in each commodity asset class in light of the fact that federal position limits will presumably apply to swap activity along with futures activity.

Upon making objective determinations as to deliverable supply levels in all commodity asset classes, the Commission should allow an appropriate opportunity for the public and market participants to provide comments as to the accuracy of those numbers. With an objective economic study made and public comments received, the Commission will be in a better position to deliberate and decide, if necessary, on the

appropriate federal spot month position limit levels for each of the relevant commodity asset classes. Upon establishment of federal limits based on updated deliverable supply estimates, the applicable designated contract markets also will be able to continue to use their discretion in setting exchange specific limits as necessary and appropriate to reduce the potential threat of market manipulation or congestion.

C. **Process for Approving Non-Enumerated Hedging Exemptions**

1. Enumerated Hedges. Commercial end users in the energy industry routinely use many different types of swaps and derivatives as a means of hedging or mitigating the complex and dynamic commercial risks of their operations. The IECA is concerned that many of these commercial risk hedging transactions will not fit readily into the Commission's proposed definition of "bona fide hedging" and the Commission's proposed list of hedges "enumerated" in paragraphs (3), (4) and (5) of Section 150.1. As discussed below, this will negatively impact market liquidity, capitalization and innovation.

- Market Liquidity – A healthy mix of actively trading market participants is critical to a functioning market. Commercial end users are a group of market participants that hedge in the market, often in spite of adverse price movements.[1] There are times, however, when today's hedge is not effective for tomorrow. This could be the case if the supply/demand fundamentals of the hedge instrument do not match the supply/demand fundamentals of the items being hedged. By applying narrow restrictions on enumerated hedge activity, the freedom a commercial end user has to utilize the most effective hedge given supply/demand fundamentals is proportionally restricted. This would negatively impact market liquidity.

- Market Capitalization – Commercial end users are generally publically traded, SEC registrants. As SEC registrants, they have fiduciary duties to bond holders and shareholders. Hedging activity is a fiduciary duty that "feeds" into corporate earnings, impacting share price and overall market capitalization. Commercial end user's business activity generally includes a portfolio of operations and their hedging activity is intertwined with many dynamic risk factors. Hamstringing commercial end users to a narrow list of enumerated hedges makes the management of risks significantly more difficult, impacting earning, share price and overall market capitalization.

- Market Innovation – An enumerated list of acceptable hedges pre-supposes that the market will not "innovate" and adapt business activity given market pricing and changing market risks. To ensure market

[1] By definition, an adverse price movement in a hedge instrument is negatively correlated to the hedge item. This occurs because commercial enterprises utilize futures as a "proxy" to hedge legitimate business activity. Stated plainly, it is a "proxy" because the legitimate business activity does not occur at the exact location or timetable as the futures at a specific delivery point and delivery period, respectively.

> innovation is not stifled, there must be a process in place that facilitates the rapidly changing market place. As proposed, however, the process for non-enumerated hedge exemptions is burdensome and inhibits innovation by requiring the innovative product to be in existence prior to granting a hedge exemption. Additionally, as discussed below, the IECA is concerned that the elimination of response deadlines by the Commission on requests for non-enumerated hedge exemptions further hinders market development.

The IECA agrees with the Commission that *bona fide* hedges reduce systemic risk by offsetting a hedger's recognized price risk, and a "hedged entity should have little incentive to manipulate or engage in other abusive market practices to affect prices."[2] Confining hedges of physical commodities to a limited list of enumerated transactions, however, will prevent commercial end-users from engaging in risk-mitigating transactions that would otherwise pose little danger of manipulation or abuse. As a result, these end users will either forego a transaction that would have reduced overall systemic market risk, would act in a manner to reduce market liquidity, would behave in a manner that could potentially negatively impact market capitalization, would lose any incentive to apply innovation in business activities, or, in the worst case, divert economic resources to foreign jurisdictions with less restrictive financial regulatory regimes.

2. The IECA is equally concerned with the absence of clear procedures and timelines by which commercial end-users will be able to obtain Commission approval of operations-critical "non-enumerated hedging exemptions." The proposed Section 150.3(e) eliminates time limits by which the Commission must act on a request for a non-enumerated hedging exemption. Retaining the 30-day and 10-day timelines in Regulation 1.47(a)(1) and (2), respectively, for any person that has submitted the requisite statements in conformance with reasonable and realistic standards to be specified by the Commission (comparable to the requirements previously set forth in Regulation 1.47) would provide clear administrative procedures for applicants and establish clear timelines by which the Commission will be required to notify such person that its proposed transactions and positions would "not be considered as bona fide hedging." Under proposed Section 150.3(e), commercial end users seeking exemptions for legitimate hedging transactions have no applicable standard by which to hold the Commission accountable for any failure to respond to such a request.

The Commission's existing procedures for granting non-enumerated hedge exemptions is not as formal, not as lengthy and contains a time frame within which the Commission must respond. Under the Position Limits Proposal, market participants are permitted to seek interpretive or no action relief from the CFTC staff under CFTC regulation 140.99. The IECA is concerned that CFTC Regulation 140.99 may only allow discretion for CFTC staff to decide if a transaction falls within enumerated hedging categories and may not grant sufficient authority for the staff to decide if a transaction is bona fide if it falls outside enumerated hedging categories. Given the lack of a deadline

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[2] See Position Limits Proposal, 78 FR 75680 at 75703.

for the CFTC to respond to a request from market participants, and given that the CFTC appears concerned that the current CFTC regulation 1.47 provision for a 30-day review period for initial filings and a 10-day review period for supplemental filings is too limiting, the IECA suggest that, rather than abandoning the timelines under CFTC regulation 1.47, that the Commission give CFTC staff authority to extend the response period when confronted with "new" and complex filings.

Lastly, formal, complex request procedures with indefinite timelines would essentially "kill" any bona fide hedge innovations for non-enumerated bona fide hedge request. Rather than introducing uncertainty in the application process, IECA strongly encourages definitive directions to market participants and CFTC staff to ensure a healthy and vibrant market.

3. The IECA is generally supportive of a pre-approval procedure for non-enumerated hedging exemptions, whereby a commercial end-user could first seek and obtain review and approval by a CFTC-regulated Exchange. Then, either the Exchange or the commercial end user can file with the Commission in writing that the review and approval has been completed by an Exchange. Upon filing, the commercial end user would be given immediate pre-approval of its non-enumerated hedging exemption, subject to final approval by the CFTC. Such pre-approval would expedite commercial activity and keep in place an existing regulatory relationship that commercial end users have with the Exchange.

If upon further review, the Commission does not approve of the pre-approval of the bona fide non-enumerated hedge exemption, then it can be subsequently denied by the Commission. Under this condition, rather than creating a "gotcha" moment for the commercial end user, the cancellation of the pre-approval would be on a "prospective basis." Sufficient recordkeeping regarding the transactions "active" under the pre-approval would need to exist so that any subsequent decision by the Commission can be reflected by the DCM or SDR. Such a pre-approval process would provide a valuable, additional tool to allow commercial end-users to pursue legitimate hedging transactions on a timely basis thereby enhancing their ability to manage commercial risks.

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

As stated in IECA's Initial PL Comments filed on February 10, 2014, the IECA fully supports excluding Trade Options from the definition of "referenced contracts" and, therefore, exempting Trade Options from the Commission's proposed position limits. In support of this recommendation, the IECA set out several key reasons, including but not limited to the following:

(i) Like forward contracts, trade options are not intended to transfer price risk from one party to another, but are both simply commercial transactions intended to transfer physical delivery and ownership of a physical commodity from one party to another.

(ii) Trade options are entered into by commercial market participants and, if exercised, result in the sale of a physical commodity for immediate or deferred shipment or delivery. The requisite intent for physical delivery of a physical commodity upon exercise under the definition of "Trade Option" provides another basis for the categorical exclusion of Trade Options from position limits. Although the requirements for forward contracts and Trade Options are phrased differently, in many respects Trade Options are functionally similar to forward contracts, when analyzed in relation to excessive speculation and other applicable contexts. Both forward contracts and Trade Options are commercial transactions used to effect physical delivery of a commodity and should be excluded from position limits.

(iii) By their terms, Trade Options are "commercial transactions" because at least one of the counterparties must be a commercial participant (a producer, processor, commercial user of, or merchant handling, the underlying physical commodity), and such commercial participant is offering or entering into the commodity option transaction solely for purposes related to its commercial business. In other words, because a Trade Option must be entered into solely for reasons related to the offeree's commercial business, it cannot also be a speculative derivative position.

(iv) Simply put, speculators will not qualify for, or be included in, Trade Options. As a result, since Trade Options are commercial and not speculative transactions, it is unclear how subjecting Trade Options to position limits would further the Commission's stated purpose to "diminish, eliminate, or prevent excessive speculation."

(v) Including Trade Options within the position limits regime subjects them to a form of analysis that simply does not fit. The Position Limits Proposal defines a significant exclusion, arising from the statutory text, for "bona fide hedges." Although Trade Options are, by definition, commercial transactions, they may not meet the requirements for a bona fide hedging position. Commercial market participants enter into swaps to hedge the price volatility underlying their physical positions, including the price volatility underlying their Trade Options. As a result, the commercial participants treat their Trade Options as the <u>basis</u> of a bona fide hedging position, just as they treat their forward contracts as the <u>basis</u> of a bona fide hedging position.

(vi) In that context, subjecting Trade Options to a position limit, and providing an exemption to the extent that the Trade Option is a bona fide hedge for a physical position, makes no sense. Commercial participants do not enter into Trade Options to hedge other physical positions, they enter into Trade Options to effect physical delivery of a commodity when that commodity is required for their commercial business.

(vii) Moreover, a commercial participant may enter into a substantial number of Trade Options in sufficient quantities to enable it to satisfy the need for a specific commodity for its commercial business. If the CFTC then orders that commercial participant to close those positions in order to not exceed the applicable position limit, what is the commercial participant to do? In general, in order to satisfy the Commission's Position Limits rule, a commercial participant cannot simply trade-out of a Trade Option position, nor can it simply close-out that position. There is not generally a liquid market for buying and selling Trade Options.

(viii) Even if the commercial participant could trade-out or close-out any Trade Option that exceeded the Commission's applicable Position Limit, that commercial participant must still obtain delivery of the commodity to meet the requirements of its commercial business and would have to attempt to replace that Trade Option with a forward contract. While the price of a new forward contract for that commodity may be substantially higher than the price under its prior Trade Option, if the commercial participant is unable to replace that commodity and that commercial participant is an electric or natural gas utility, then that commercial participant may be forced to violate its regulatory obligation to provide reliable electricity or natural gas to its customers in order to comply with the Commission's position limits.

(ix) In addition, subjecting Trade Options to position limits would impose a complex new regulatory regime on a category of commercial transactions that has never been subject to position limits set by the Commission or any of the exchanges. In this regard, these unnecessary regulations would require, among other things, compliance with complex and costly monitoring, recordkeeping, and reporting requirements despite the fact that the Commission has elsewhere excluded Trade Options from a majority of the Commission's swap regulations.

(x) Excluding Trade Options from position limits would not permit commodity options that should be regulated as swaps to circumvent the protections established in the Dodd-Frank Act for the forward contract exclusion for non-financial commodities. The Commission will continue to have access to sufficient data regarding Trade Options as a result of the Commission's recordkeeping requirements to enable the Commission to investigate allegations of inappropriate behavior and enforce its anti-fraud and anti-market manipulation rules.

Based on these reasons and the additional discussion set forth in IECA's Initial PL Comments, the IECA strongly believes that there is no stated or apparent benefit to the Commission that would justify the tremendous burden this proposed position limits rule will create for the IECA's members if the proposed position limits rule includes Trade Options. The IECA cannot emphasize enough, that if the Commission elects to subject trade options to position limits ***it will effectively be precluding utilities and other***

commercial market participants from using trade options (at certain levels) to procure supply or commodity inputs to production – an outcome that could jeopardize the stability of this nation's electric grid and adversely impact the reliability of other critical components of the nation's energy industry.

E. Enterprise "Gross" Hedging

Although the term "enterprise" is not defined in the Position Limits Proposal, the Commission appears to have adopted a general requirement that market participants must hedge risks on an aggregate, enterprise-wide basis. An aggregated enterprise commercial risk hedging requirement, however, may preclude end-users from qualifying as a *bona fide* hedger because there will be aspects of the commercial enterprise that will have offsetting operational risks.

For example, if a power company hedges its power purchases, but does not hedge its power sales, the power purchase hedges will not qualify for the exemption under the Position Limits Proposal because the transaction does not account for the natural "short" of sales to customers. The Commission's interpretation of the economically appropriate test, therefore, will prohibit commercial end-users from engaging in transactions that, in practice, constitute an economically appropriate commercial risk hedge.

The IECA recommends that the Commission define the term "enterprise" to permit hedging by profit center, line of business, regulatory jurisdiction or other group of related operations or commercial activities that comprise a subset of a particular legal entity or group of related legal entities. Such a definition would adapt the economically appropriate test to the portfolio of interest defined by a particular commercial market participant for the purposes of measuring and managing operational risk.

F. Cross-Commodity Hedging

Regarding Cross-Commodity Hedging, the IECA notes that in its Position Limits Proposal, the Commission concludes "By way of example, the Commission believes that fluctuations in the value of electricity contracts typically will not be substantially related to fluctuations in value of natural gas."[3] The IECA objects to that generalized conclusion if the CFTC relies on it to, for example, exclude from the substantially related safe harbor a power plant's natural gas derivative contracts that hedge exposure to electricity price movements in the applicable cash market for electricity generated by that power plant.

A substantial relationship between the prices of natural gas and electricity has been long recognized by energy market participants as well as various energy regulators, including the Federal Energy Regulatory Commission which recently (March 20, 2014) issued a series of orders designed to better align the scheduling of natural gas and electricity to improve price efficiency and reliability in energy markets.

[3] See Position Limits Proposal, 78 FR 75680 at 75717.

The IECA submits that no quantitative factor should be required for a commercial end-user who legitimately believes, in the exercise of its business judgment, that its proposed cross-commodity hedge transaction will allow it to minimize an aspect of its commercial risk. There should not be a requirement of quantitative success in managing commercial risk, but rather the standard should be the commercial end-user's bona fide exercise of its business judgment to conclude that a cross-commodity transaction will allow it to manage its commercial risk.

G. Utility Hedging Rules

In the Position Limits Proposal, the Commission has said "The proposed new exemption would recognize a bona fide hedge position where a utility is required or encouraged to hedge by its public utility commission."[4] This is not how utility regulation works.

State public utility commission ("PUCs") "allow" prudently incurred costs to be recovered. PUCs generally don't "require" or "encourage" hedging; rather, they may allow it, and they may also after-the-fact disallow recovery of hedging costs or losses because of a failure to hedge when that hedge would have been prudent. PUCs "encourage" entities they regulate to be prudent. PUCs generally don't "encourage" before the fact hedging; rather they punish for lack of prudency after the fact.

At a minimum, the CFTC's rule should read "is not prohibited from hedging" rather than "required or encouraged to hedge." Similarly, the Commission should not condition its proposed bona fide hedge exemption for unfilled anticipated requirements for resale by a utility on instances in which a utility is *"required or encouraged to hedge by its public utilities commission."*

H. Unpriced Physical Purchase or Sale Commitments

Regarding Unpriced Physical Purchase or Sale Commitments, the Commission Staff has asked for identification of various so-called "plus factors" that would support a commercial enterprise establishing that the nature of its commercial operation is such that it has committed physical or financial resources toward the anticipated transaction. The IECA submits that there are numerous examples in the energy industry.

For example, a developer anticipates building a large power plant that will sell its electricity output in the available merchant markets with no present forward contract for the electrical output of the power plant. In order for that developer to obtain financing from lenders to enable it to build the power plant, the developer may enter into a long-term hedging transaction that will provide a floor on its revenues from its merchant sales. The developer will then enter into a credit agreement to finance construction of the power plant, an equipment purchase contract for the turbines and other materials necessary to construct that power plant, a fuel purchase agreement for the fuel required to operate that

[4] See Position Limits Proposal, 78 FR 75680 at 75824.

power plant, and various other contractual arrangements. Each of those contracts, while clearly not a forward contract for the sale of the electrical output of the power plant, would be “plus factors” which indicate that the “commercial enterprise” has “committed physical or financial resources towards the anticipated transaction.”

The same would be true for an oil and/or natural gas developer who anticipates selling its oil, natural gas or other hydrocarbons in the available market place, but does not now have any forward contract for the output of its intended drilling program. That developer will enter into leases for prospective oil and gas mineral rights, a borrowing base loan agreement with a lender (or multiple lenders), a drilling rig contract to drill the proposed wells, and a pipeline construction agreement to build the means necessary to gather its hydrocarbon output and move it to market. But, in order to get its lenders to enter into the loan agreement and provide the funds to perform its drilling operations, the developer may have to enter into a long-term hydrocarbon hedging transaction first or simultaneously with entering into the loan agreement in order to put a floor on the oil and gas revenues the developer will receive to repay its loan. In that case, each of the developer’s contracts, while again not a forward contract for the sale of the hydrocarbon output of its wells, would be “plus factors” which indicate that the “commercial enterprise” has “committed physical or financial resources towards the anticipated transaction.”

II. Alternate 3-Part Approach to Applying Position Limits to OTC Swaps: (i) Leverage End-User Exception to Clearing Criteria; (ii) Implement Speculative Notification Thresholds, and (iii) Employ Position Limits as a Tool to Diminish, Eliminate, or Prevent the Undue and Unnecessary Burden on Interstate Commerce in a Commodity Arising from Excessive Speculation.

The objective of CEA Section 4a(a)(1) is “diminishing, eliminating, or preventing” the “undue and unnecessary burden on interstate commerce in [any] commodity” arising from “excessive speculation in [such] commodity…causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity.” In fulfilling that objective, the Commission is instructed by CEA Section 4a(a)(1) to “from time to time … proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person, including any group or class of traders, … as the Commission finds are necessary to diminish, eliminate, or prevent such burden.”

At the same time, CEA Section 4a(c)(1) expressly states that “No rule, regulation, or order issued under subsection (a) of this section shall apply to transactions or positions which are shown to be bona fide hedging transactions or positions as such terms shall be defined by the Commission by rule, regulation, or order <u>consistent with the purposes of this chapter</u>. Such terms may be defined to permit producers, purchasers, sellers, middlemen, and users of a commodity or a produce derived therefrom to hedge their legitimate anticipated business needs.” CEA Section 4a(c)(2) then instructs the

Commission to "define what constitutes a bona fide hedging transaction or position" following the provisions set forth in subsection 4a(c)(2)(A) and (B).

CEA Section 4a(a)(2) instructs the Commission to "establish limits on the amount of positions, as appropriate, other than bona fide hedge positions, that may be held by any person." Further, CEA Section 4a(a)(3)(B) specifies that "In establishing the limits required in paragraph (2), the Commission, as appropriate, shall set limits – (A) … and (B) to the maximum extent practicable, in its discretion – (i) to diminish, eliminate, or prevent excessive speculation as described under this section; (ii) to deter and prevent market manipulation, squeezes, and corners; (iii) to ensure sufficient market liquidity for bona fide hedgers; and (iv) to ensure that the price discovery function of the underlying market is not disrupted."

The IECA submits that an alternate 3-part approach to position limits, developed by a couple of the members of the IECA, can assist the Commission with fulfilling its statutory mandate to diminish, eliminate or prevent the undue and unnecessary burden on interstate commerce of excessive speculation, and deter and prevent market manipulation, squeezes and corners, but with less risk of imposing undue and unnecessary burdens on bona fide hedging transactions by commercial end-users and with less risk of adversely affecting the market liquidity required for bona fide hedgers, while ensuring that the price discovery of the underlying market is not disrupted.

A. Leverage the End-User Exception to Clearing Criteria

The Commission has stated that the purpose of defining bona fide hedging positions is to distinguish hedging positions from those that are speculative. (See Position Limits for Derivatives; Proposed Rule, 78 Fed. Reg. 75680, 75761 (December 12, 2013)). Fortunately, the standard for "bona fide hedging position" in CFTC Regulation 150.1 is essentially the same as the end-user exception to clearing under CFTC Regulation 50.50(c) *Hedging or mitigating commercial risk*.

OTC market participants who elect the end-user exception to clearing already attest that these transactions are "not used for a purpose that is in the nature of speculation, investing, or trading," as a result of CEA Section 4a(6)(c)(2) and CFTC Regulation 50.50(c)(2). Accordingly, the end-user exception to clearing remains substantially identical to the requirements to qualify for the bona fide hedging exemption.

Currently, commercial end-users and others eligible for the end-user exception to clearing notify their counterparty of their election to exercise the end-user exception and specify, on a swap-by-swap basis that the end-user exception to clearing applies (or does not apply) to each such swap. As a result, a framework already exists for making that election (subject to board approval for SEC filers).

Adding additional criteria to the end-user exception to clearing criteria would be less burdensome than applying the list of "enumerated hedging positions" as set forth in the Position Limits Proposal.

Under this alternate proposal, the counterparty would assert, on a swap-by-sway basis, that it is a bona fide hedging position based on the end-user exception to clearing criteria.

B. Implement Speculative Notification Threshold(s)

The CFTC does not currently have direct access to OTC speculative activity by OTC market participants. Nevertheless, OTC market participants should still monitor any speculative OTC positions. In this alternate approach, the OTC market participants would provide a window into that OTC speculative activity.

Each OTC market participant entering into speculative transactions would be subject to certain volumetric thresholds ("Notification Thresholds") to be set by the Commission on a volumetric basis, perhaps as a percentage of the deliverable supply for specific commodities. This Notification Threshold would be set low enough to give the Commission warning of market events with sufficient time to act to impose self-expiring position limits on a specific commodity (as set forth in Part II.C below), but high enough to avoid the Commission receiving so many email notices of an OTC market participant having exceeded a Notification Threshold that the information is not indicative of a potentially pending future occurrence of excessive speculation.

If, at any time, an OTC market participant holds positions in speculative transactions that, in the aggregate, exceed the Notification Threshold, that OTC market participant would be obligated to send an email to the Commission notifying the Commission that it has exceeded the Notification Threshold for a specific commodity.[5]

As a result of such email notification, the Commission would receive market data that it currently does not receive. The data from these notices of an OTC market participant having surpassed a Notification Threshold could be used by the Commission, together with price movements and other data collected from SEFs, DCOs, DCMs, and SDRs to provide the Commission with the data necessary for it to assess whether there is evidence of "excessive speculation" with respect to a particular commodity.

The CFTC would use the email notice of having surpassed a Notification Threshold to ascertain whether to request additional information from the OTC market participant submitting such email notice.

C. Employ Position Limits as a Tool to Diminish, Eliminate or Prevent the Undue Burdens of Excessive Speculation

If the Commission's existing market pricing data, combined with this new Notification Threshold data, suggests that excessive speculation may be affecting the

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[5] This email notification would be comparable to the $1 billion threshold for email notification required to be submitted by counterparties to Trade Options, only the threshold would be set on a volumetric basis in lieu of a dollar basis.

market price for a specific commodity, then the Commission could use that data to impose "self-expiring" position limits on aggregate speculative positions held in such commodity.

Such "self-expiring" position limits would be in effect for a specified period of 30, 60 or 90 days to be determined by the Commission.

If markets come back into balance, then such self-expiring speculative position limit would be allowed to expire under their own terms. If the Commission determines that markets for such commodity have not come back into balance, then the self-expiring position limit could be extended by the Commission at the expiration thereof, but only by an affirmative action of the Commission. (No automatic extension of any specific position limit would be permitted.)

The IECA submits that such a "self-expiring" position limit would better match the requirements of CEA Section 4a(a)(1) which states that "the Commission shall from time to time, after due notice and opportunity for hearing, by rule, regulation or order proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person." (Emphasis added.)

The IECA submits that speculative position limits are a tool best utilized "from time to time" to suppress unreasonable or unwarranted changes in the price of a commodity. Utilizing speculative position limits as a permanent policy, as set forth in the Position Limit Proposal, would only serve to diminish liquidity and essentially ignores the Commission's obligations, under CEA Section 4a(a)(3)(iii) and (iv), which stipulates that the Commission is "to the maximum extent practicable, in its discretion – (iii) to ensure sufficient market liquidity for bona fide hedgers; and (iv) to ensure that the price discovery function of the underlying market is not disrupted."

To the extent that the Commission's use of permanent speculative position limits removes liquidity from regional or national markets for specific commodities, then neither of the Commission's objectives in CEA Section 4a(a)(3)(iii) or (iv) would be achieved.

Employing these self-expiring position limits, as more fully described in these Comments, as a tool to diminish, eliminate or prevent the undue burdens of excessive speculation should allow the Commission to achieve all the objectives of CEA Section 4a(a)(3).

Conclusion.

The IECA appreciates the opportunity to provide the foregoing comments and information to the CFTC. This letter represents a submission of the IECA, and does not necessarily represent the opinion of any particular member. If you would like for us to expand our discussion of any of the above-listed discussion points, please let us know.

Yours truly,
INTERNATIONAL ENERGY CREDIT ASSOCIATION

/s/	/s/
Phillip G. Lookadoo, Esq.	Jeremy D. Weinstein
Haynes and Boone, LLP	Law Offices of Jeremy D. Weinstein