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Via Electronic Submission

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

Attn: Mr. Christopher J. Kirkpatrick
Secretary of the Commission

Re: Position Limits for Derivatives and Aggregation of Positions (RIN 3038-AD99).

Dear Mr. Kirkpatrick:

I. Introduction

EDF Trading North America, LLC ("EDFTNA") submits these comments in response to the Position Limits for Derivatives and Aggregation of Positions (RIN 3038-AD99) proposed rulemaking published by the Commodity Futures Trading Commission (the "CFTC" or the "Commission") in the February 25, 2015 edition of the Federal Register (the "Proposed Rules").[1]

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, through its affiliated companies, a provider of retail power and gas services to large-scale commercial and industrial customers.

In general, EDFTNA appreciates the Commission's efforts to put forth final position limit and aggregation rules, as well as, the Commission's ongoing effort to continue its dialog with the industry by reopening the comment period for the Proposed Rules. EDFTNA acknowledges that there are several important issues surrounding the concept of position limits and the Proposed Rules, many of which have been addressed in previous open comments periods and were discussed at the February 26, 2015 Energy and Environmental

[1] 80 FR 10022 (February 25, 2015).

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Markets Advisory Committee Meeting ("EEMAC"). While EDFTNA recognizes and appreciates the complexity and importance of these issues concerning the Proposed Rules, EDFTNA would like to use this opportunity to address specific items it considers as fundamental to not only its business strategy but to the business strategies of its counterparties' as well. Consistent with the views expressed by other market participants, EDFTNA believes that the proposed rules regarding the data and methodology used to determine position limits, enumerated bona fide hedges, position aggregation, and the management of hedge exemptions are at the forefront of the discussion concerning position limits. Specifically, EDFTNA would like to address the following issues regarding: (a) the management and administration of hedge exemptions remaining with the ICE U.S. Futures, CME, etc. (collectively hereafter the "Exchanges") with oversight provided by the CFTC; (b) the recommended use of current actual data estimates based on not only supply and demand, but the physical infrastructure (e.g., generation capacity, transfer capability, etc.) of the energy commodities market within the U.S. to determine deliverable supply estimates; (c) the further expansion of the Commission's recognition of enumerated hedges with regard to the industry's practices surrounding "anticipatory merchandising", particularly concerning physical storage capacity, the reconsideration and possible elimination of the proposed 0.80 quantitative factor required for "cross-commodity hedges"; and (d) the extension of the finalized position limit and aggregation rules' implementation schedule.

II. Comments

(a) EDFTNA request that the Commission address the following issues regarding (i) the potential management of federal position limits and hedge exemptions by the futures exchanges; (ii) whether the current position limit regime using accountability levels has been ineffective in preventing or capturing excessive speculation and, therefore, the industry needs position limits beyond the spot month; and (iii) industry concerns regarding the Commission's plan and ability to respond in a timely manner to market participants' real-time requests for non-enumerated hedge exemption and ongoing management of enumerated hedge exemption requests.

i. The futures exchanges have a deeply-rooted position limit framework making them the industry's most qualified participant for the prevention of excessive speculation, and therefore the exchanges should manage position limits, accountability levels, and hedge exemptions for energy commodities at an exchange level and at the proposed federal level.

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EDFTNA is sympathetic to the Commission's obligation pursuant to Congressional mandate to prohibit excessive speculation, especially given the absence of industry consensus of whether position limits are effective in preventing excessive speculation.

In light of arguments for or against position limits, should the Commission consider position limits as the requisite solution in preventing excessive speculation of commodities transactions, EDFTNA requests that the Commission consider incorporating their proposed position limits regime into the existing framework managed by the Exchanges. The exchange set position limit process has served the industry well for several years, is well managed, efficient, and fit for purpose. In today's climate of commodity trading, both futures exchanges and market participants manage the adherence to position limits through contemporaneous efforts and through the conduct of formal and informal communications. EDFTNA believes market participants and exchanges alike are comfortable and have a unique familiarity with the current futures-exchange-set position limits and aggregation processes. Collectively, both the Exchanges and market participants have developed an effective working relationship whereby position limits are managed for the benefit of the entire market and are managed with the aim of protecting the interests of both producers and consumers of energy in addition to market intermediaries. This is not to suggest that such a relationship could not or cannot exist between market participants and the CFTC.

The Proposed Rules would in effect unsettle the current relationship between energy market participants and exchanges by having the CFTC perform daily administration and oversight of federal position limits and the granting of hedge exemptions for the 4 core referenced energy commodity contracts in addition to the existing regulation conducted by the Exchanges. The proposed evolution of the CFTC to a market regulator having direct practical daily implementation of market regulation, a role which the Exchanges currently exercise such authority, would potentially burden and entangle an otherwise relatively simple process. This transformation could unduly complicate the current and or future position limit management process. Furthermore, to now adopt an approach that alters the CFTC's role with regard to position limits to one that involves the direct oversight of position limits implies that the current process and administration of position limits has been ineffective in the prevention of excessive speculation and we would assert that there is essentially no evidence

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to support such an implication. EDFTNA has found the administration of the position limits compliance by the Exchanges to be effective and as such supports the continuation of this oversight.

Therefore, EDFTNA request that the Commission reconsider its approach to more actively participate in the daily administration of position limits to an approach that includes a position limit regime that reflects the current processes administered by the Exchanges;

ii. The Exchanges' combined use of spot month limits and accountability levels is a large contribution to the successful management and administration of the current position limit regime.

As mentioned above, EDFTNA has seen no evidence presented throughout the drafting of the Proposed Rules to suggest that the current position limit and hedge exemption process under the Exchanges is dysfunctional or inadequate for the management of position limits. Remarkably, the Exchanges have done so by maintaining the delicate balance of enforcing hard limits while permitting the markets to continue their growth and flexibility with regard to price discovery and executing transactions for hedging purposes, as needed. However, should the Commission determine that a federal position limits framework should be implemented to compliment the Exchanges' position limit process, then EDFTNA would encourage the Commission to consider enacting accountability levels beyond the spot month as opposed to inelastic limits. EDFTNA believes that such accountability levels, rather than limits, would permit the CFTC to carry out its mission of ensuring transparency, protecting market participants, and safeguarding market integrity, while allowing the market to operate effectively and continue to grow.

Fundamentally, market participants need to retain the flexibility to execute speculative transactions outside of the spot month thereby providing liquidity and market efficiency throughout the forward curve for the benefit of producers and consumers of energy products. Furthermore, the current structure of accountability levels affords market participants an opportunity to demonstrate the conduct and performance of risk management, but perhaps more importantly, the current framework gives market participants a forum to provide rationale of their speculative transactions to regulators.

End users' needs and demands are constantly changing, vastly different, and largely influenced by volatile factors formidably outside the end users' control. EDFTNA, like many industry participants, feels that

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the proposed position limits beyond the spot month would adversely impact market liquidity, discourage rather than encourage market participation, and may result in abnormal market prices for end user hedgers. For example, end user hedgers may experience an increase in the price of products and services due to intermediaries seeking greater in order to offset illiquidity risk exposures because of position limits beyond the spot month. Market intermediaries' reluctance or inability to conduct transactions could lead to larger bid-ask spreads, erratic price movements, and market inefficiency. The proposed position limits beyond the spot month would effectively operate as a barrier to market entry for longer dated activities in the name of unnecessarily preventing a shallow threat of excessive speculation beyond the spot month.[2] Ultimately, the higher cost of doing business within the marketplace will be felt by the American consumer, which ultimately will have negative consequences for the American economy.

iii. EDFTNA request that the Commission address industry' concerns regarding the Commission's proposed plan and ability of the CFTC to promptly respond to requests for non-enumerated bona fide hedge approval and manage enumerated hedge exemption requests?

EDFTNA shares the industry's concern of whether the CFTC is capable of meeting the proposed mandate of responding and granting bona fide hedge exemption requests. The proposed plan for the CFTC to issue exemption requests would require increased resources and more man power than are currently available to the Commission. In light of the importance for granting exemption requests to market participants, EDFTNA believes that the current framework regarding hedge exemptions provides commercial market participants with the efficacy and the timeliness needed to ensure they are able to hedge their risks. EDFTNA humbly request that the Commission address industry concerns regarding the Commission's proposed plan and ability to timely respond to requests for bona fide hedge exemption.

[2] "Moreover, it is widely acknowledged, including by the Commission, that the threat of manipulation outside of the spot month is greatly diminished." *See* ICE Futures U.S., Position Limits for Derivatives RIN 3038-AD99, page 4.

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(b) Deliverable supply estimates based on commodity specific, actual physical transport/transmission, generation, and production would provide the best deliverable supply estimates in preventing price manipulation, market congestion, or the abnormal movement of a commodity in interstate commerce and ensure the appropriate convergence of cash and futures prices.

The Commission has had a longstanding policy that spot month speculative position limits for physical delivery and cash-settled futures contracts are appropriately set as a function of deliverable supplies. Given the availability of acceptable data, deliverable supply estimates should be based on actual and available physical transmission, generation, and storage capacity release potential reflective within the particular contracts' location. Consistent with the view expressed by other market participants, EDFTNA believes that deliverable supply estimates should be based on a particular location and the generation capacity and total transfer capability within and into the catchment area of a contract. EDFTNA contends that access to this information is readily available and accessible to assist the Commission in establishing deliverable supply estimates. The physical capabilities for providing physical energy commodities (e.g. natural gas) to end users, including flows from storage, properly reflect real world estimates of physical capacity readily available to meet consumer demand. In addition, as newly constructed physical generation, storage, or transmission is brought online, the resetting of the deliverability assessments on a regular basis would allow for the inclusion of new construction in establishing the deliverable supply estimates; resulting in estimates that are closely in sync with the physical market infrastructure.

As stated within the federal regulations, "an adequate measure of deliverable supply would be an amount of the commodity that would meet the normal or expected range of delivery demand without causing futures prices to become distorted relative to cash market prices".[3] The actual pipeline capacity, gas outflow capacity from storage or maximum generation capability is a reflection of the "normal or expected range of delivery" and would, in accordance with regulations, serve as an "adequate measure of deliverable supply". Using this methodology reduces the risk of futures, swaps, and option prices from being inflated or "distorted relative to cash market prices" largely because the prices would be based on the actual/maximum amount of supply that can be delivered at that location and would accurately reflect, to the extent possible, true market

[3] 17 Part 38, Appendix C(b)(i)(A)

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conditions for that particular season.[4] During the EEMAC, ICE Futures U.S. stated that they consume and analyze a great deal of data to ensure that the markets operate efficiently, to identify market stress factors, and to understand how participants operate and utilize the markets. The data provided by the exchanges and other market participants is readily available and use of such data in developing deliverable supply estimates would represent the best practices of a proven technique or methodology in line with the desired results and accuracy needed to reflect physical market conditions.[5]

Furthermore, deliverable supply estimates should account for the variations in deliverable supplies and the unique nature of various energy products. The use of a "one size fits all" approach for calculating deliverable supply estimates would not accurately account for the differences in physical infrastructure for the transmission/transport of energy products to various locations throughout the U.S.[6] Deliverable supply should take into account exceptional relationships between energy products, such as that between natural gas and electricity. EDFTNA agrees with other market participants that natural gas estimates should be based on the volume of gas that can be transported to fulfil demand, including volumes injected or released from storage, and that power estimates must recognize the transmission potential of generation from other areas. Careful consideration should be given to the specific quantities and the flow of commodities through standard commercial channels and to the existence of any external factors or controls that could potentially affect the price or supply of energy commodities (e.g., pipeline or generation facility maintenance).

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[4] "Given the availability of acceptable data, deliverable supply should be estimated on a monthly basis for at least the most recent three years for which data are available. To the extent possible and that data resources permit, deliverable supply estimates should be constructed such that the data reflect, as close as possible, the market defined by the contract's terms and conditions, and should be formulated, whenever possible, with government or publicly available data." *See* 17 Part 38, Appendix C(b)(i)(A).

[5] "The estimate should be based on statistical data, when reasonably available, covering a period of time that is representative of the underlying commodity's actual patterns of production, patterns of consumption, and patterns of seasonal effects (if relevant)." *See* 17 Part 38, Appendix C(b)(i)(C).

[6] To assure the availability of adequate deliverable supplies and acceptable levels of commercial risk management utility, contract terms and conditions should account for variations in the patterns of production, consumption and supply over a period of years of sufficient length to assess adequately the potential range of deliverable supplies. *See* 17 Part 38, Appendix C(b)(i)(B).

(c) The Commission should further amend the definition of a bona fide hedge by expanding the Commission's recognition of enumerated hedges with regard to a definition that: (i) includes "anticipatory merchandising" hedging, particularly with regard to anticipated storage capacity; and (ii) that eliminates the use of a required 0.80 quantitative correlation factor for "cross-commodity hedges".

i. Hedging of unfilled storage capacity is a long held industry practice and should be recognized by the CFTC as an anticipated merchandising bona fide hedge.

As stated in previously submitted comments to the CFTC, EDFTNA humbly 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)7, because hedges of storage capacity service are economically appropriate and in the conduct and management of a commercial enterprise aids in risk reduction.[8] Specifically, EDFTNA request that the Commission recognize anticipatory merchandising transactions with regard to storage capacity as meeting the second "appropriateness" prong of the Commission's definition of a bona fide hedging transaction.[9] 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."[10] Typically a market participant who owns or leases storage capacity typically buys and sells futures of the same underlying commodity with a calendar spread to hedge the intrinsic and extrinsic time spread inherent in its storage capacity. EDFTNA respects the Commission's position under the Proposed Rules regarding the value fluctuations in the calendar month spread and their low correlation with the value fluctuations in expected returns, however, it is this type of market volatility that supports a firm's need to anticipatorily hedge such potential risks. By the Commission's own admission, the difference in the anticipated supply and demand of a commodity on different dates confirms active use of calendar month spread transactions as just the type of

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[7] *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).
[8] *See* EDFTNA "*Comments Regarding Position Limits for Derivatives and Aggregation of Positions* (RIN 3038-AD82)", August 4, 2014.
[9] *Id* at 71646
[10] *Id* at 71646

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hedging behavior for which a market participant would justly utilize if the market participant were to own or lease storage capacity.

EDFTNA again proposes 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 bona fide hedges[11], contemporaneously with the anticipatory merchandiser being required to meet the new filing requirements under the Proposed Rule.[12] EDFTNA continues to believe that these provisions, combined with the Commission's proposed bona fide hedge exemption reporting requirements, are sufficient for the Commission and the Exchanges to monitor market participant behavior and for the market participant to manage its risks. Conversely, restricting and limiting market participants' ability to conduct hedge activities will undermine commercial enterprises risk strategy and harmfully impact the development and promote underutilization of natural gas physical storage capacity in the U.S. energy markets.

Furthermore, EDFTNA feels that recognition of bona fide hedge exemption for natural gas physical storage capacity is available pursuant to the Commission's mandate that the trader have a reasonable certainty that he or she will engage in the anticipated merchandising activity.[13] Foreseeably, with reasonable certainty a trader could determine that the demand for or supply of natural gas could fluctuate with respect to the weather or a particular season and as a result the trader can anticipate that natural gas owners or distributors would like to purchase or sell gas storage to hedge their future physical price exposure. In addition, an owner or lessor of physical gas storage capacity can reasonably anticipate being exposed to unfilled capacity due to volumetric movements in the supply of natural gas or perhaps due to a shortage in available storage capacity. This type of anticipated merchandising is a well-established hedging largely supported by a trader's reasonable certainty and trading acumen that he or she will more likely than not engage in this type of hedging strategy.

[11](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

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

[13] *Id* at 71646-71647

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ii. The 0.80 quantitative correlation requirement for cross-commodity hedges is overly burdensome, not fit for purpose, and will undoubtedly result in illiquid hedging markets for end user consumers.

The Proposed Rule introduces a qualitative and a quantitative factor to determine if cross-commodity hedges qualify for bona fide hedge treatment. 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 factor for a time period of not less than 36 months.

As stated within previously submitted comments, EDFTNA agrees that the Commission should require market participants to show some reasonable degree of correlation with regard to cross-commodity hedging. However, EDFTNA contends that the proposed 0.80 correlation factor is without cause and will constrain legitimate industry recognized cross-commodity hedges.[14] The use of the 0.80 correlation factor ignores and fails to consider traditional commercial market practices that represent best available hedge combinations. Under the Proposed Rules 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 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."[15] 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. The current threshold of quantitative factor operates more as a barrier to market entry rather than a facilitator of market liquidity and hedging opportunities. Natural gas serves as a primary feedstock for many power generators. Naturally, these power generators typically hedge their exposure to electricity prices by transacting in natural gas financial derivatives. Such a power generation plant wanting to reduce its exposure to electricity prices may hedge its forward price exposure and not necessarily spot commodity price. EDFTNA would like to restate its request that the Commission consider not requiring such a stringent and ill fitted correlation factor for all cross-commodity hedges.

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[14] *Id* at "*Comments Regarding Position Limits for Derivatives and Aggregation of Positions* (RIN 3038-AD82)", August 4, 2014.
[15] *Id* at 75717

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Alternatively, if the Commission determines that a correlation factor is needed for cross-commodity hedges, EDFTNA, again, suggests that the Commission consider developing a correlation factor that accounts for the correlation between the futures price series that expire around the same time as the hedged exposure. A 0.80 correlation factor for at least 36 months does not translate universally across all energy commodity industry hedge strategies or across the management of the identified 28 core commodities in all derivatives markets. Spot prices may be influenced by weather, erratic or spontaneous activity occurring at the physical site of production (e.g., a transportation pipe malfunctions or generation outage), or perhaps due to a confluence of other intervening factors. These factors, together with standard industry practices, should be accounted for when establishing specific cross-commodity correlation factors.

Given that numerous variables could influence the construction of a correlation factor, the Commission should extend some flexibility to commercial market participants in the performance and execution of risk management transactions with regard to cross-commodity hedges. EDFTNA agrees with The Commercial Energy Working Group ("The Working Group") that "the standard applied by the Commission under these circumstances should be that of a retrospective, 'bad faith' review".[16] The Commission should consider giving deference to market participants that cross-commodity hedges are performed in good faith and should such a transaction appear questionable the Commission could exercise its plenary authority to investigate and prosecute such behavior in accordance with due process.

Further to The Working Group's point, alternatively, if the Commission were to adopt a standard of review that looks at hedging activity on a prospective basis, the Commission may consider evaluating cross-commodity hedges under a "totality of the circumstances" review basis.[17] Here the Commission would evaluate cross-commodity hedges based on whether the market participant "reasonably expect[ed] the commodity derivative transaction to reduce risk".[18]

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[16] *See* The Commercial Energy Working Group, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (August 4, 2014)

[17] *Id* at 9

[18] *Id*

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(d) Given the complexity and surmounting controversy of the Proposed Rule, EDFTNA would like to request that the Commission strongly consider adopting a phase in schedule for compliance and implementation of the final position limit and aggregation rules.

EDFTNA request that the Commission provide market participants with more than the statutory minimum of 60 days to come into compliance with revised rules once the Proposal has been finalized due to the operational impact and complexity of implementing such requirements as those discussed within the Proposed Rule. As in the past, market participants in good faith will work diligently to implement processes, procedures, and training that comply with the Commission's enacted regulations. However, the potential aggregation of multiple affiliates positions for position limits and enhancements of existing monitoring processes poses technical and administrative burdens. Therefore, EDFTNA suggest that the Commission not require compliance with the final position limit rule for at least 6 months from the date the final rule is published in the Federal Register.

III. Conclusion

EDFTNA appreciates the opportunity to provide the Commission with the foregoing comments in connection with the Proposed Rules. If you would like additional information or have any questions regarding this submission, please feel free to contact Mr. Paige Lockett, Manager of Regulatory Affairs for EDFTNA, at 281-921-9826.

Respectfully submitted,

EDF Trading North America, LLC