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July 13, 2016

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

VIA ELECTRONIC SUBMISSION

Re: SUPPLEMENTAL NOTICE OF PROPOSED RULEMAKING, POSITION LIMITS FOR DERIVATIVES: CERTAIN EXEMPTIONS AND GUIDANCE, RIN 3038-AD99

Dear Secretary Kirkpatrick:

I. INTRODUCTION.

Castleton Commodities International LLC ("CCI") appreciates the opportunity to submit this letter commenting on the Supplemental Notice of Proposed Rulemaking, *Position Limits for Derivatives: Certain Exemptions and Guidance* issued by the Commodity Futures Trading Commission (the "CFTC" or "Commission") in the above-referenced proceeding and published in the *Federal Register* on June 13, 2016 (the "Supplement").[1] The Supplement proposes additions and other revisions to the CFTC's proposed rulemaking, *Position Limits for Derivatives* (the "Proposed Rule").[2]

CCI is an independent global commodities merchant. CCI's primary business activity is the merchandising, marketing, warehousing, and trading of a wide range of physical and financial energy and other bulk commodities. As part of this business, CCI owns and operates physical assets, such as power plants, midstream and upstream natural gas, natural gas liquids, and oil production facilities, and ships. CCI has more than 900 employees across four continents. In addition to its Stamford, Connecticut headquarters, CCI has domestic offices or facilities located in Colorado, Louisiana, Maryland, New Mexico, New York, North Carolina, Pennsylvania, Texas, Utah, Virginia, and West Virginia, and international offices in Canada, China, Singapore, Switzerland, the United Kingdom, and Uruguay.

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[1] *See Position Limits for Derivatives: Certain Exemptions and Guidance*, Supplemental Notice of Proposed Rulemaking, 81 Fed. Reg. 38,458 (June 13, 2016).

[2] *See Position Limits for Derivatives*, Notice of Proposed Rulemaking, 78 Fed. Reg. 75,680 (Dec. 12, 2013).

CCI submits this limited set of comments to address specific aspects of the Supplement and, more broadly, the potential impacts on the ability of commercial market participants to effectively manage their risks under federal position limits on energy commodities. In addition, CCI generally supports The Commercial Energy Working Group's comments on the Supplement.[3]

II. EXECUTIVE SUMMARY.

CCI supports the Supplement's basic proposed framework of delegating authority to designated contract markets ("DCMs") and swap execution facilities ("SEFs")[4] to make preliminary determinations as to whether certain transactions and positions may be exempted from federal speculative position limits as non-enumerated bona fide hedges ("Non-Enumerated BFHs"), enumerated anticipatory bona fide hedges ("Anticipatory BFHs"), or as certain exempt spread transactions or positions ("Spread Exemptions").[5] Structurally, this proposal appropriately places the responsibility for determining whether certain transactions and positions qualify as Exemptions with the entities that possess the experience, expertise, and resources to effectively and actively manage the Exemption process – the Exchanges.

Notwithstanding its general support for the Supplement's goals, CCI believes that the Supplement's proposed limitations on the Exchanges' discretion for administering the Exemptions would create an entirely new paradigm different from current Exchange practice for granting exemptions from exchange-set speculative position limits and would:

i. Create confusion among market participants regarding the process pursuant to which Exemptions may be granted;

ii. Produce unintended consequences that will harm the ability of market participants to reliably manage their risks associated with their physical commodity exposures; and

iii. Effectively undermine the Commission's stated objective of leveraging the over thirty years of Exchange expertise in this area by restricting the Exchanges' flexibility and discretion to respond to market needs and trends in their application of the Exemptions.

CCI is concerned that certain aspects of the Supplement (i) will not provide any discernible regulatory benefits, (ii) could cause market disruptions and harm price discovery, and (iii) will impose significant and unnecessary costs. In particular, CCI is concerned that, if the

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[3] The Commercial Energy Working Group, Comments on the *Supplemental Notice of Proposed Rulemaking, Position Limits for Derivatives: Certain Exemptions and Guidance*, RIN 3038-AD99 (July 13, 2016) (submitted concurrently herewith).

[4] DCMs and SEFs are referred to collectively herein as the "Exchanges."

[5] Non-Enumerated BFHs, Anticipatory BFHs, and Spread Exemptions are referred to collectively herein as the "Exemptions."

Five-Day Rule[6] is applied as an absolute restriction on enumerated BFHs, cross-commodity hedges, Non-Enumerated BFHs, or Spread Exemptions, liquidity will be driven away from critical price-formation contracts during the time it is needed most for price discovery and price convergence between physical and financial commodities markets. As discussed in Sections III.B and III.C, CCI believes that the Exchanges are best positioned to protect the orderly operation of their markets and currently possess adequate authority under their own Commission-approved market rules and applicable Core Principles to actively manage the Exemption process, including liquidations of exempt-sized, physical-delivery Referenced Contract positions during the Spot Month, at a far more nuanced and granular level than that contemplated in the Proposed Rule or Supplement.

Finally, as addressed in Section III.B, certain procedural requirements proposed in the Supplement require clarification to prevent unintended consequences resulting from potentially inconsistent interpretations of the final rule by market participants, the Exchanges, and the Commission. In particular, the Commission should focus its attention on (i) clarifying how Exemptions will apply to particular underlying positions, (ii) limiting Exemption application data to those commodity derivatives contracts for which such an exemption is sought, (iii) limiting Non-Enumerated BFH Exemption application data to a single year of related historical cash market activity, and (iv) eliminating unnecessary or duplicative reporting obligations.

III. COMMENTS OF CCI.

A. Procedural Concerns that Must Be Addressed in any Final Rule Issued in this Proceeding.

1. The Supplement Unnecessarily Restricts the Exchanges' Flexibility in Granting Exemptions.

Under proposed CFTC Regulations 150.9(a)(1), 150.10(a)(1), and 150.11(a)(1), an Exchange may recognize an Exemption for a particular Referenced Contract if, among other things, the Referenced Contract is "actively traded" by such Exchange, and the Exchange has at least "one year of experience" in administering exchange-set position limits for such Referenced Contract. Enumerated BFHs for the exact same Referenced Contracts available to market participants under proposed CFTC Regulations 150.1(3)-(4) and cross-commodity hedges under proposed CFTC Regulation 150.1(5) are not subject to similar limitations.

CCI believes that market participants' ability to seek relief from federal position limits for the same Referenced Contract should not be limited whether such relief comes in the form of an enumerated BFH, a cross-commodity hedge, a Non-Enumerated BFH, or a Spread

[6] The Five-Day Rule restricts the ability of market participants to hold a physical-delivery Referenced Contract as an enumerated BFH set forth in proposed CFTC Regulations 150.1(3)(iii), or 150.1(4)(i)-(iv), or as a cross-commodity hedge under proposed CFTC Regulation 150.1(5) in the lesser of the last five days of trading or the time period for the spot month of the relevant contract. *See* Proposed Rule at 75,710, 75,713-16. Where applicable in energy commodity markets, the Five-Day Rule will become effective at "the close of trading on the trading day preceding the third-to-last trading day, until the contract is no longer listed for trading (or available for transfer, such as exchange for physical transactions) (the "Spot Month"). *See* proposed CFTC Regulation 150.1 (defining the term "Spot Month").

Exemption. There is no legal or policy justification that supports the proposed restrictions. In contrast, Commodity Exchange Act ("CEA") Section 4a(a)(3)(B)(iii) specifically states that the Commission must, to the maximum extent practicable, "ensure sufficient liquidity for bona fide hedgers."

The Supplement's stated goal is to utilize the Exchanges' expertise and experience when transactions or positions fall outside the enumerated BFH categories set forth in proposed CFTC Regulations 150.1(3)-(4), particularly with respect to Non-Enumerated BFHs and Spread Exemptions. When compared to the enumerated BFHs, the Exchanges ability to grant Exemptions should not be artificially limited by the trading activity in a particular commodity derivative contract or whether such contract is newly-listed by an Exchange. Should the Commission adopt these restrictions in any final rule issued in this proceeding, they could have the unintended consequences of (i) harming the ability of market participants to effectively manage their risk by preventing the Exchanges from recognizing an otherwise appropriate Exemption from federal speculative position limits,[7] and (ii) stifling future innovation in the development of new commodity derivative products created to meet evolving market needs and demands.

Accordingly, CCI recommends that the Commission not adopt the "active trading" and "one year experience" requirements as proposed in the Supplement. To the extent that the Commission has concerns about the ability of Exchanges to manage speculative position limits and Exemptions for newly developed Referenced Contracts, CCI suggests that such concerns can be adequately addressed through the Commission's rule enforcement review process and through general Exchange oversight.

2. Exchange Coordination and Clarification on the Exemption Application Process Are Needed to Prevent Market Confusion.

The Supplement lacks necessary clarity and guidance on how the Exemption process for federal position limits will work across the Exchanges.[8] Specifically, other than the discussion in footnote 131, the Supplement fails to address whether market participants are required (i) to apply to a single Exchange for Exemptions, or (ii) to every Exchange listing a Referenced Contract that relates to the same Core Referenced Futures Contract ("CRFC").[9]

The Commission should expressly clarify that market participants should be required to make an application only to a single Exchange that lists a Referenced Contract for which an Exemption is sought, and such application would broadly cover all Referenced Contracts related

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[7] Such unintended consequences could include, but would not be limited to, situations where the relevant facts and circumstances establish a legitimate commercial basis for which an Exemption may be granted by an Exchange and sufficient liquidity exists in a newly-listed commodity derivative contract justifying such an Exemption.

[8] CCI believes that the Supplement does not propose requiring the Exchanges to adopt the Exemption process set forth in proposed CFTC Regulation 150.9 for purposes of administering exemptions from exchange-set position limits. If the Supplement is proposing such a requirement, CCI does not support such proposal and believes the Exchanges should be accorded the flexibility and discretion to administer exemptions from exchange-set position limits in the same manner they currently apply.

[9] *See* Supplement at 38,471 n.131.

to the same CRFC. In other words, proposed CFTC Regulations 150.9-150.11 should not require market participants to submit duplicative applications to multiple Exchanges when seeking to manage the same exposures using Referenced Contracts listed on different Exchanges that relate to the same CRFC. Such a process would be an inefficient and wasteful use of both Exchange and market participant resources, as well as, Commission resources in providing oversight of the Exemption process administered by the Exchanges.

Finally, CCI recommends that any final rule issued in this proceeding should direct the Exchanges to implement a process that would allow them to timely coordinate and share information with respect to (i) Exemptions granted to market participants by other Exchanges and (ii) resolve any conflicts between the Exchanges' views on whether a requested Exemption is, in fact, appropriate.

B. Substantive Concerns that Must Be Addressed in any Final Rule Issued in this Proceeding.

1. Granting Exemptions on a Position or Transaction-Specific Basis is Unduly Burdensome and Contrary to Market Risk Management Practices.

The Proposed Rule proposes to allow a market participant to manage its risks either on a portfolio basis *or* a one-to-one transaction basis.[10] The ultimate determination regarding what approach to apply is left to the discretion of market participants to allow them to act in a manner that is consistent with their internal risk management programs and policies used to manage their businesses. In this vein, an Exemption granted by an Exchange should not be limited to the hedging of a single, identified risk or spread transaction or position.

Market positions, particularly those of a size requiring exemptions, typically are composed of multiple risk exposures to the underlying physical commodity, which may incorporate several different strategies and hedging activities. If each Exemption recognized by an Exchange must be for a single strategy or hedging requirement, market participants could be required to file multiple applications at various Exchanges. For example, if a market participant wished to employ five distinct time spread strategies for one product across two exchanges, the Supplement suggests it would need to file ten exemption applications to establish what effectively is one net position in that product. Such a requirement would be very costly and unnecessarily burdensome, especially for companies that hedge risks across several desks, assets, or affiliates.

Accordingly, CCI recommends that any final rule adopted in this proceeding should clarify that the Exchanges may recognize and grant Exemptions on the basis of a strategy (*e.g.*, time spreads), or hedging need (*e.g.*, demonstrated storage facility exposure), or a combination of strategies or hedging requirements associated with managing an ongoing business. That is, the Commission must clarify that market participants may apply for and receive Exemptions that cover either a portfolio of risk exposures or a specific transaction/position, as appropriate to the applicant's particular business.

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[10] *See* Proposed Rule at 75,835, Appendix C to Part 150, Example 1.

2. Applications for Exemptions Should Not Require Data that is Not Relevant to the Specific Exemption Sought.

Although CCI appreciates the need for Exemption applications to provide Exchanges with sufficient information for them to determine, and the Commission to verify, whether a requested Exemption is consistent with CEA Section 4a(c), the proposed Exemption process represents a significant departure from existing Exchange practices[11] and appears to move well beyond the realm of leveraging existing Exchange expertise. As more thoroughly described below, CCI has identified certain proposed elements of the Exchange application process that require submission of information that is significantly broader or wholly unrelated to the facts and circumstances needed to support a requested Exemption.[12] CCI recommends that any final rule adopted in this proceeding appropriately tailor its requirements and give more discretion to Exchanges under the Exemption application process.

a. Applicants Should Be Required to Submit Position Data Only for the Commodity Derivative Contract for Which a Non-Enumerated BFH or Spread Exemption Is Sought.

Although the Supplement notes that proposed CFTC Regulation 150.9(a)(3)(iii) is based on existing CFTC Regulation 1.47(b)(4), it appears to require a much broader set of information. Specifically, proposed CFTC Regulation 150.9(a)(3)(iii) requires an applicant to provide "a statement concerning the maximum size of all gross positions in derivative contracts to be acquired by the applicant during the year after the application is submitted."[13] On its face, proposed Regulation 150.9(a)(3)(iii) appears to require the compilation of gross positions for every commodity derivative contract the applicant holds.

If CCI's interpretation of this proposed provision is accurate, then it is overly broad in scope, unnecessary, and unduly costly. Moreover, the unnecessarily broad reach of this provision does not provide any additional regulatory benefit to the Exchange when reviewing a Non-Enumerated BFH application or to the Commission when reviewing an Exchange's determination to grant the Non-Enumerated BFH application.

CCI believes applicants for Non-Enumerated BFHs should be required to submit information only on the maximum size of net positions for the specific commodity derivative

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[11] Given that the proposed regulations for Exchange recognition of Non-Enumerated BFHs in proposed CFTC Regulation 150.9 is substantially similar to the proposed regulations for Spread Exemptions under proposed CFTC Regulation 150.10, CCI's comments addressing the Non-Enumerated BFH process under proposed CFTC Regulation 150.9 apply equally to the Spread Exemption process set forth in proposed CFTC Regulation 150.10. In addition, as specifically noted in Section III.B.3., CCI raises concerns that apply equally not only to the Non-Enumerated BFH and Spread Exemption processes under proposed Regulations 150.9 and 150.10, respectively, but also to the Anticipatory BFH process under proposed Regulation 150.11.

[12] If the Commission seeks information broader than that related to the Referenced Contract(s) and offsetting cash market positions for which an Exemption is sought, it may use its special call authority under proposed CFTC Regulation 150.3 and existing CFTC Regulation 18.05. The Exemption application process should not be utilized to gather such information.

[13] *See also* Proposed CFTC Regulation 150.10(a)(3)(iii).

contract for which the specific Non-Enumerated BFH is sought. Accordingly, CCI recommends the Commission revise proposed CFTC Regulation 150.9(a)(3)(iii) as follows:

> "A statement concerning the **anticipated** maximum size of ~~all~~**the** ~~gross~~ **net** position~~s~~ in **the commodity** derivative contract~~s~~ **for which the application is submitted** to be acquired by the applicant during the year after the application is submitted."

b. Applicants Seeking Non-Enumerated BFHs Should Be Required to Submit Only One Year of Historical Data on Its Cash Market Activities.

Proposed CFTC Regulation 150.9(a)(3)(iv) requires an applicant to submit three years of historical data on its cash market activity for the underlying commodity for which it seeks a Non-Enumerated BFH.[14] CCI believes that the submission of one year of data with respect to an applicant's cash market activity sufficiently demonstrates legitimate engagement in the commercial activities for which a proposed Non-Enumerated BFH exemption is sought. Existing Exchange practice requires only one year of data and CCI believes the Exchanges should be permitted to continue this practice. If additional information is needed from the applicant, both the Exchanges and Commission may request such information as part of the application process.[15]

3. Applicant Reporting of Exemptions Under Proposed CFTC Regulations 150.9(a)(6), 150.10(a)(6) and 150.11(a)(5) Provides No Incremental Market Surveillance Benefit and Should Not Be Adopted By the Commission.

Proposed CFTC Regulations 150.9(a)(6), 150.10(a)(6) and 150.11(a)(5) require an applicant receiving an Exemption from an Exchange to file a report identifying the applicant's offsetting cash positions or components of a spread, as applicable, and subsequently update and maintain the accuracy of such report. As a result, an applicant would have to file a report upon (i) initially establishing a position in a contract for which it holds an Exemption and (ii) modifying such position as its hedging needs change with dynamic market conditions. CCI submits that applicant reporting of positions relating to its Exemptions as contemplated in proposed CFTC Regulations 150.9(a)(6), 150.10(a)(6) and 150.11(a)(5) is unnecessarily burdensome for the following reasons.

First, such reports are required even if an applicant does not exceed an applicable position limit when a position is initially established. Further, the obligation to update reports might require an applicant to submit reports as often as every day when adjusting its position. Such updating would be very costly for many energy market participants that dynamically hedge a portfolio of risk exposures, particularly when the portfolio covers several desks within and across several affiliates (which may be located globally).

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[14] There is no corresponding provision applicable to Spread Exemptions.

[15] *See* proposed CFTC Regulations 150.9(a)(4)(ii) and 150.9(d)(ii).

Information or other data obtained through applicant reporting under proposed CFTC Regulations 150.9(a)(6), 150.10(a)(6) and 150.11(a)(5) does not appear to provide any incremental market surveillance or other regulatory benefit in light of (i) proposed CFTC Regulations 150.9(a)(4)(i), 150.10(a)(4)(i), and 150.11(a)(3)(i), each of which require a market participant to reapply for an Exemption at least on an annual basis and provide updates to submitted information, (ii) real-time market surveillance activities conducted by the Exchanges which protects markets from potential disruption and abuse, (iii) the Exchanges' ability to seek additional information from a market participant if they suspect potential violations of position limits or other market rules, and (iv) the Commission's ability to seek further information related to utilization of an Exemption through its special call authority set forth in proposed CFTC Regulation 150.3 and existing CFTC Regulation 18.05.

In light of the foregoing, proposed CFTC Regulations 150.9(a)(6), 150.10(a)(6) and 150.11(a)(5) should be rejected.

4. <u>The Five-Day Rule Should Not Apply as an Absolute Restriction to Holding Physical-Delivery Referenced Contracts in the Spot Month</u>.

CCI does not support the application of the Five-Day Rule to market participants seeking to hold a physical-delivery Referenced Contract in the Spot Month as part of a request for certain enumerated BFHs under proposed CFTC Regulations 150.1(3)-(4), cross commodity hedges under proposed CFTC Regulation 150.1(5), Non-Enumerated BFHs, or Spread Exemptions. Preventing market participants from receiving such relief from applicable speculative Spot Month position limits for physical-delivery Referenced Contracts would reflect an unprecedented departure from existing exemption practices as well as energy market operations. If the Commission requires the application of the Five-Day Rule to certain enumerated BFHs, cross-commodity hedges, Non-Enumerated BFHs, or Spread Exemptions, the ability of market participants to effectively manage their risks will be materially harmed and efficient market function will be impaired.

Consistent with statements in the Supplement, the Exchanges are equipped to evaluate the facts and circumstances supporting an Exemption application. In this respect, CCI believes that the Exchanges are best positioned to protect the orderly function of their markets and may effectively determine whether it would be appropriate for an applicant to hold certain transactions or positions in the Spot Month. As noted in Section II, above, the Exchanges actively manage the hedge exemption process in energy markets and liquidations at contract expiry at a far more nuanced and granular level than the Supplement contemplates. In this respect, the Exchanges will permit energy market participants to hold positions in physical-delivery Referenced Contracts in excess of applicable Spot Month limits where the relevant facts and circumstances appropriately support such action.

CCI and many other market participants have the ability to hold an exempt-sized, physical-delivery Referenced Contract position into the Spot Month and through expiry, as well as to actually make or take delivery. Although CCI appreciates the Commission's concerns with respect to preventing disorderly liquidations of exempt-sized positions of physical-delivery Referenced Contracts in the Spot Month, this is a concern that has been adequately and appropriately addressed by the various Exchanges for energy markets. The arbitrary application

of the Five-Day Rule as an absolute restriction to certain enumerated BFHs and cross-commodity hedges, as well as to Non-Enumerated BFHs and Spread Exemptions, has a significant potential to drive away liquidity from the critical price-formation contracts during the final days of trading in the relevant Referenced Contract. This is the exact period of time that such liquidity is most needed for price discovery and to create price convergence between physical and financial markets.

Accordingly, the Commission should not adopt a final rule in this proceeding that applies the Five-Day Rule to certain enumerated BFHs under proposed CFTC Regulation 150.1(3)-(4), cross-commodity hedges under proposed CFTC Regulation 150.1(5), as well as to Non-Enumerated BFHs, or Spread Exemptions. Instead, the Commission should permit the Exchanges to determine the appropriate facts and circumstances where a market participant may be permitted to hold a physical-delivery Referenced Contract in the Spot Month as part of a position that is exempt from federal speculative position limits.

C. The Commission Should Clarify that the Exchanges Have Full Discretion when Making Determinations to Grant Exemptions.

Consistent with statutory and Commission objectives, any final rule adopted in this proceeding must not restrict the ability of market participants to effectively manage their risk. In this regard, the Commission should provide the Exchanges with full flexibility and discretion to make determinations, weighing all relevant facts and circumstances regarding the eligibility of Exemption applications. More specifically, the Commission should not adopt conclusions made in the Proposed Rule that certain risk-reducing transactions or positions did not meet the general BFH definition, such as the "change in value" requirement or "economically appropriate" test[16] and instead permit the Exchanges to assess whether Exemption applications meet the general BFH definition set forth in proposed CFTC Regulation 150.1 and the policy objectives of CEA Section 4a(3)(B).

IV. CONCLUSION.

CCI appreciates this opportunity to provide comments on the Supplement and requests the Commission's consideration of them. CCI expressly reserves the right to supplement these comments as appropriate.

Respectfully submitted,

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[16] *See* Proposed Rule at 75,719-22.