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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.

On behalf of The Commercial Energy Working Group (the "**Working Group**"), Sutherland Asbill & Brennan LLP hereby submits this letter in response to the request for public comment set forth in the Commodity Futures Trading Commission's (the "**CFTC**" or "**Commission**") Supplemental Notice of Proposed Rulemaking, *Position Limits for Derivatives: Certain Exemptions and Guidance* (the "**Supplemental Proposal**"),[1] which proposes additions and other revisions to the CFTC's pending proposed rulemaking, *Position Limits for Derivatives* ("**Proposed Rule**"),[2] including new alternative processes for designated contract markets ("**DCMs**") and swap execution facilities ("**SEFs**") (collectively, the "**Exchanges**") to recognize exemptions from federal speculative position limits for non-enumerated *bona fide* hedges ("**NEBFHs**"), spread positions ("**Spread Exemptions**") and enumerated anticipatory *bona fide* hedges ("**Anticipatory BFHs**") (collectively, the "**Exemptions**").

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. Among the members of the Working Group are some of the largest users of energy derivatives in the United States and globally. The Working Group considers and responds to requests for comment

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[1] *See Position Limits for Derivative: 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).

regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

The Working Group has been an active participant in the Commission's rulemaking process and has continually worked to maintain a constructive dialogue on the development of an appropriately tailored framework for federal speculative position limits. The Working Group requests that the Commission consider the comments provided herein, which supplement comments previously submitted by the Working Group in this proceeding, and urges the Commission to continue its dialogue with market participants and, importantly, the Exchanges, so that it may finalize a workable framework for federal speculative position limits that relies upon and utilizes the Exchanges' expertise and resources.[3]

II. COMMENTS.

A. Utilizing the Exchanges' Expertise to Assess Applications for Exemptions from Federal Speculative Position Limits Will Effectively Enable Commercial Hedging Under an Appropriate Regulatory Framework While Preserving Commission Resources.

The Working Group supports the Commission's efforts to develop a framework that relies upon the expertise of the Exchanges for purposes of administering the Exemptions. For the reasons described below, utilizing the Exchanges in this manner will allow commercial market participants to effectively manage their risks. The regulatory objective in preventing excessive speculation will be protected by Commission rules, requirements placed on the Exchanges, the Exchanges' own self-interests, and Commission oversight.

1. The Exchanges Have the Regulatory Infrastructure to Ensure that the Exemptions Meet the Requirements of Section 4a(3)(B) of the Commodity Exchange Act ("**CEA**").

Pursuant to Exchange rules, before an exemption from exchange-set speculative position limits is granted, a market participant must, among other things, (i) provide a complete and accurate description of the underlying exposure relating to an exemption request, (ii) agree to provide further information upon request from the Exchange, (iii) agree to liquidate positions in an orderly manner when so ordered by the Exchange, and (iv) represent compliance with all

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[3] *See* The Commercial Energy Working Group, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (Mar. 30, 2015) ("**March 30 Letter**"); The Commercial Energy Working Group, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (Aug. 4, 2014) ("**August 4 Letter**"); The Commercial Energy Working Group, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (Feb. 10, 2014) ("**February 10 Letter**") (collectively, the "**Comment Letters**"); *see also* The Commercial Energy Working Group presentations and comments provided at the CFTC's June 19, 2014 Position Limits Roundtable, *available at* https://www.youtube.com/watch?v=jx5ZryxlRsI&feature=youtu.be; https://www.youtube.com/watch?v=pbKC8GJeQGU&feature=youtu.be; February 26, 2015 Energy and Environmental Markets Advisory Committee ("**EEMAC**") Meeting, *available at* https://www.youtube.com/watch?v=yGLWQsuqZ-w&feature=youtu.be; and July 29, 2015 EEMAC Meeting, *available at* https://www.youtube.com/watch?v=xpE-sthXOws&feature=youtu.be.

other Exchange rules.[4] This regime has been in place since 1981.[5] Exchanges have a long history of successfully scrutinizing applications, and the record demonstrates that they do not simply "rubber stamp" them.[6]

After an exemption is granted, the Exchanges actively monitor participants' positions. To perform this function, among other things, the Exchanges (i) employ well-trained market surveillance teams that are experts in current market conditions, (ii) communicate regularly with market participants to understand their trading strategies and intentions, and (iii) where appropriate, request and receive detailed information from market participants.[7] If an Exchange has concerns with the size of a market participant's position under an exemption from speculative position limits, it has, and will use, authority under its Commission-approved market rules to "jawbone" or order the market participant to reduce such position and ensure that such position does not create a threat to orderly markets.[8] The Exchanges also may require a market participant to reduce its positions by modifying or revoking an exemption.[9]

2. Core Principles Require the Exchanges to Manage the Exemption Process Efficiently.

The Commission also may rely upon the Exchanges to administer and manage the Exemption process properly, as they carry out their regulatory duties under applicable DCM and SEF Core Principles.[10] Specifically, DCM Core Principle 4 and SEF Core Principles 4 and 5 obligate the Exchanges to monitor trading, as well as surveil their markets for anomalies to prevent manipulation, price distortion, disruptions of the delivery or cash-settlement process, and position limits violations. In addition, DCM Core Principle 5 and SEF Core Principle 6 require the Exchanges to implement and enforce speculative position limits and accountability levels to reduce the threat of market manipulation or congestion (especially in the delivery month). The collective obligations imposed on the Exchanges under these Core Principles will ensure the Exchange Exemption process is effectively managed to preserve orderly markets.

3. Exchanges Have Strong Incentives to Manage the Exemption Process Cautiously and Diligently.

Given their intimate knowledge of physical commodity markets and the commercial practices of participants in such markets, the Exchanges are best positioned to determine which

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4 *See, e.g.*, New York Mercantile Exchange ("**NYMEX**") Rule 559; ICE Futures U.S. ("**IFUS**") Rule 6.29; Nodal Exchange Rule 6.5; NASDAQ Futures Rules Chapter V, Section 13(d).

5 *See Establishment of Speculative Position Limits*, Final Rule, 46 Fed. Reg. 50,938 (Oct. 16, 1981).

6 *See* Supplemental Proposal at 38,470, n.127 (noting, for example, during the period from June 15, 2011, to June 15, 2012, IFUS received 142 exemption applications and granted 92 of them).

7 *See, e.g.*, NYMEX Rules 559, 560; IFUS Rules 6.13, 6.29(b).

8 *See, e.g.*, NYMEX Rule 560.

9 *See, e.g.*, NYMEX Rule 559; IFUS Rule 6.29(b).

10 *See* CFTC Regulations 37.400-08 (SEF Core Principle 4); 37.500-04 (SEF Core Principle 5); 37.600-01 (SEF Core Principle 6); 38.250-58 (DCM Core Principle 4); 38.300-01 (DCM Core Principle 5).

transactions and positions should receive exemptions from applicable federal speculative position limits. As recognized by the Exchanges and the Commission, in addition to the Core Principles, the Exchanges have self-interest in protecting market participants from the harm speculative position limits are intended to prevent, such as ensuring that (i) the price of the spot futures contract converges with the cash price,[11] and (ii) a market participant with an exemption does not trade in a manner that causes adverse price impacts to the market.[12]

4. The Commission Retains Full Oversight of the Exchange Exemption Process through the Rule Enforcement Review Process.

Through its rule enforcement review process, the Commission oversees the Exchanges' compliance with their Core Principles, including the implementation and enforcement of speculative position limits under SEF Core Principle 6 and DCM Core Principle 5.[13] The CFTC has conducted several rule enforcement reviews covering DCM Core Principle 5 and exemptions from speculative position limits,[14] and intends to perform similar reviews of SEFs in the future.[15] Although the Commission identified deficiencies or made limited recommendations for improvement, the Working Group did not find a single instance where a rule enforcement review attributed excessive speculation or disorderly markets to the abuse of an Exchange hedge exemption process.[16] Importantly, the Supplemental Proposal does not in any way diminish the Commission's ability to oversee through its rule enforcement review process the Exemption process and, in fact, enhances the Commission's ability to effectively oversee commodity derivatives markets through the use of the Exchanges who are best positioned to administer and monitor the Exemptions.

B. Revisions to the Supplemental Proposal Are Needed to Ensure that the Commission Achieves its Goal of Finalizing a Speculative Position Limit Rule that Does Not Impede Upon the Ability of Commercial Market Participants to Effectively Manage Risk.

The overriding principle in allowing commercial market participants the opportunity to hedge their risks with derivatives is that, by reducing risks in the supply chain, the costs of commodities to consumers ultimately will be reduced. Chairman Massad and each sitting Commissioner have repeatedly asserted that, before a speculative position limit rule should be finalized, care must be taken to ensure that the rule does not restrict the ability of commercial

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11 *See* Supplemental Proposal at 38,468-69, n.116; 38,488-89.

12 *See id.* at 38,488-89.

13 *See* Supplemental Proposal at 38,469, n.126.

14 Recent rule enforcement reviews included: (i) the Minneapolis Grain Exchange, Inc. (June 5, 2015); (ii) IFUS (July 22, 2014); (iii) the Chicago Mercantile Exchange ("**CME**") and Chicago Board of Trade ("**CBOT**") (July 26, 2013); and (iv) NYMEX (May 19, 2008). *See* Supplemental Proposal at 38,469, n.126.

15 *See* Supplemental Proposal at 38,469, n.126.

16 *See http://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/dcmruleenf.*

market participants to manage risk.[17] The recommendations provided herein by the Working Group seek to accomplish that objective. The Working Group's recommendations are consistent with the statutory requirements under the CEA[18] and Commission intent underlying the issuance of the Supplemental Proposal, and do not present any additional risk of excessive speculation.

1. The Commission Should Expressly State that the "Additional Facts and Circumstances" that Are Available to Exchanges in Administering Exemptions Would Permit the Recognition of a Broad Array of Exemptions, Including Anticipatory Merchandising.

Since the passage of the Dodd-Frank Act,[19] the Commission and market participants have spent considerable time and resources analyzing whether anticipatory merchandising and other risk-reducing derivatives activity warranted exemption from federal speculative position limits. In the Proposed Rule, the Commission expressed the view that certain risk-reducing transactions and positions posited by the Working Group would qualify for an exemption.[20] In other circumstances, the Commission opined that certain risk-reducing transactions or positions posited by the Working Group would not qualify, reasoning such transactions or positions failed to meet the "change in value" requirement or the "economically appropriate test" ("**Rejected Bona Fide Hedge ("BFH") Strategies**"),[21] conclusions with which the Working Group respectfully disagrees.

If such conclusions are adopted by the Commission in any final rule issued in this proceeding, an Exchange could be prevented from granting NEBFH recognition to these and other risk-reducing transactions and positions, as the Exchange might find it difficult to conclude that such transactions and positions meet the general BFH definition in proposed CFTC

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17 *See, e.g.*, Supplemental Proposal at 38,514, Appendix 2—Statement of Chairman Timothy G. Massad; Keynote Remarks of Chairman Timothy Massad before the Global Exchange and Brokerage Conference, New York, NY (June 9, 2016), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-47; Keynote Remarks of Chairman Timothy Massad before the Institute of International Bankers Annual Washington Conference (Mar. 7, 2016), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-43; Remarks of Timothy G. Massad before the Coalition for Derivatives End-Users (Feb, 26, 2015), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-12; Remarks of Commissioner Sharon Y. Bowen before the District of Columbia Bar (Jan. 12, 2016), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opabowen-7; Statement of Commissioner Sharon Y. Bowen, Meeting of the Agricultural Advisory Committee (Sept. 22, 2015), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/bowenstatement092215; Keynote Address of CFTC Commissioner J. Christopher Giancarlo before the American Cotton Shippers Association Annual Conference (May 26, 2016), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-16; Opening Statement of Commissioner J. Christopher Giancarlo Before the First Meeting of the CFTC's EEMAC (Feb, 26, 2015), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement022615; *see also* February 10 Comments at n.14 (providing statements made by former Chairman Gensler and former Commissioners Chilton, Wetjen, and O'Malia supporting the same proposition).

18 *See* CEA Sections 4a(c)(1); 4a(a)(2); 4a(3)(B).

19 H.R. 4173, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

20 *See* Proposed Rule at 75,719-22.

21 *Id*.

regulation 150.1 in light of the Commission's conclusions.

Importantly, however, in the Proposed Rule, the Commission stated that it might have reached a different conclusion and granted BFH treatment to the Rejected BFH Strategies if it had access to "additional facts and circumstances."[22] The Supplemental Proposal provides the appropriate vehicle for the Exchanges to require, receive, and analyze those additional facts and circumstances or "plus factors" that the Commission was interested in obtaining for purposes of determining the appropriateness of an exemption from federal speculative position limits, all while remaining subject to Commission oversight.[23]

Under the Supplemental Proposal, the Exchanges would have the ability to identify the particular market participant seeking an Exemption in advance of a speculative position limit being exceeded (in contrast to enumerated BFH exemptions where the Commission would be notified of a claim for an exemption only after the positions were established in excess of a speculative position limit, potentially after the spot month had passed and the contract expired). In addition, the Exchanges will be able to analyze and assess (i) the market participant's history in using the derivative contract in question, (ii) the market participant's commercial operations and business, (iii) its wherewithal to make or take delivery, if appropriate, and (iv) its employment of personnel, such as schedulers, charterers, and operators, employment of capital, use and extension of credit, ownership or leases of storage capacity, contractual commitments to pipeline transportation capacity, ownership or charters of vessels or barges, and investment in technology and infrastructure. The Exchanges also will be able to assess a specific Exemption application (and use of such Exemption, if granted) in the context of a particular market and its characteristics, including trade liquidity, number of market participants, and any unique supply/demand fundamentals or idiosyncrasies that may impact the ability of the market to absorb larger positions and remain orderly.

Accordingly, the Working Group recommends that, in any final rule adopted in this proceeding, the Commission expressly state that the Exchanges are permitted, if the facts and circumstances warrant, to recognize as a NEBFH those Rejected BFH Strategies, including anticipatory merchandising transactions or positions.

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[22] *See* Proposed Rule at 75,719-20; *see also* Division of Market Oversight ("**DMO**") Position Limits Roundtable: Revised Staff Questions, Questions 11 and 12 under the First Session (published June 18, 2014), *available at* http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/staffquestions061214.pdf; February 26, 2015 EEMAC Meeting Transcript, at Panel III, p. 168-70 (DMO staff noting that one of the Rejected BFH Strategies involving a merchandising hedge was rejected since the CFTC could not establish "plus factors" that could distinguish between a speculator buying at unfixed price and using that as a pretext for an exemption and a merchant buying at unfixed price as part of its normal business practice and who had transportation arrangements in place—of which ICE and CME would have considered); EEMAC Meeting Transcript, at Panel III, p. 180-82 (In responding to the Chairman's question about why a Working Group hedging example was denied BFH treatment under the Proposed Rule, DMO staff stated that it received a generic example without any context or "enough facts" about the commercial hedger's business), *available at* http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/emactranscript022615.pdf.

[23] *See* n.21, supra.

2. To be Effective, Application of the Five-Day Rule[24] to All Exemptions (Whether Enumerated BFHs, NEBFHs, or Spreads) Requires an Analysis of the "Facts and Circumstances," and Therefore, Reliance upon the Exchanges' Expertise to Make Preliminary Determinations is Warranted—a Hard and Fast Prohibition is Inappropriate.

The Supplemental Proposal does not apply the Five-Day Rule to NEBFHs or Spread Exemptions but requests comment on whether the Five-Day Rule should be applied to NEBFHs or Spread Exemptions.[25] As stated in its Comment Letters, the Working Group does not support the application of the Five-Day Rule to a market participant wishing to receive an exemption for a physical-delivery Referenced Contract held in the spot month. Because market facts and circumstances often exist that require a commercial market participant to hold into the spot month certain hedge positions that utilize physical-delivery futures contracts to effectively manage their exposures to price risk,[26] energy markets will be severely disrupted if the Commission adopts the Five-Day Rule as an absolute restriction on any enumerated BFH, NEBFH, or Spread Exemption.[27] For the reasons discussed below, the Working Group urges the Commission to abstain from applying the Five-Day Rule to any enumerated BFHs, NEBFHs, or Spread Exemptions as an "absolute" prohibition and, instead, allow the Exchanges to consider the "facts and circumstances" and permit commercial hedging in the spot period for energy contracts where the facts and circumstances warrant.

The Commission never has meant for the Five-Day Rule to be an absolute prohibition to receiving a BFH exemption under federal speculative position limit rules. As the Commission stated in 1977 when it first adopted the Five-Day Rule, "Persons wishing to exceed [the Commission's speculative] limits during the five last trading days may submit materials supporting classification of the positions as bona fide hedging pursuant to [CFTC Regulation 1.48] and paragraph [1.3(z)](3) of the newly adopted [BFH] definition [pertaining to non-enumerated transactions and positions]."[28]

Likewise, in administering speculative position limits outside of the federal regime, the Exchanges have been free to grant exemptions in the last five days of trading ("spot month exemptions") in energy contracts and have regularly done so. Exchanges have followed the

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[24] The "Five-Day Rule" refers to the Proposed Rule's proposed restriction on a market participant's ability to obtain a BFH exemption for a physical-delivery Referenced Contract held during the lesser of the last five days of trading or the time period for the spot month in such physical-delivery commodity derivative contract. *See* Proposed Rule at 75,710.

[25] *See* Requests for Comment ("**RFC**") 7-9 and 20-22.

[26] For example, a market participant may need to hold a cross-commodity hedge into the spot month where (i) the underlying commodity hedged can be blended and delivered under the applicable Referenced Contract or (ii) the related purchase or sale contract (or inventory to be used to satisfy a sale contract) that is being hedged must be held or priced through the spot month. *See* August 4 Letter at 10; February 10 Letter at 47-51.

[27] *See* March 30 Letter at 15-16 and Attachment 2, slides 14-28; August 4 Letter at 10; February 10 Letter at 47-53.

[28] *See Definition of Bona Fide Hedging and Related Reporting Requirements*, Final Rules, 42 Fed. Reg. 42,748, 42,749-50 (Aug. 24, 1977).

application and monitoring process described above seemingly without incident.[29] Given the final rule issued in this proceeding likely will eliminate CFTC Regulations 1.3(z)(3) and 1.48, by adopting the Five-Day Rule as set forth in the Proposed Rule (or adding it to the requirements for NEBFHs or Spread Exemptions), the Commission effectively would be reversing course and establishing an absolute restriction on managing risks in energy markets in excess of applicable speculative position limits in the last five days of trading or the spot month that has never previously existed.

Conversely, allowing the Exchanges the discretion to determine whether the Five-Day Rule should apply to a requested Exemption[30] is consistent with the Supplemental Proposal, which recognizes that, in some circumstances, bright line prohibitions should give way to a "facts and circumstances" analysis to avoid a speculative position limit rule that inhibits the ability of commercial market participants to manage risk. The Exchanges are best positioned to evaluate the facts and circumstances (*e.g.*, market liquidity, an applicant's business and historical and current trading activity) surrounding an exemption application, including whether it is appropriate to permit certain transactions or positions to be held in the spot month. Indeed, the Exchanges currently evaluate such application requests in energy markets and permit transactions and positions involving physical-delivery futures contracts to be held in the spot month above the applicable speculative position limit when the facts and circumstances support such action.

Additionally, Exchanges have other tools to ensure that permitting hedging in the last few days of an expiring contract does not create the risks that the Commission is concerned about, namely, that the price discovery process in Core Referenced Futures Contracts approaching expiration will be disrupted.[31] For example, where market conditions warrant, an Exchange may permit a market participant to hold a physical-delivery futures contract to hedge its exposures in the spot month, but require the market participant to reduce or "step down" its position in that contract as the spot month progresses towards expiry to avoid the risk of disorderly liquidation. Specifically, where the applicable speculative limit is 1,000 contracts, an Exchange may grant a market participant an exemption to hold 3,000 contracts on the third day prior to the expiry of that contract, and require the market participant to reduce its position to no more than 1,500 contracts on the second day prior to expiry and 1,000 contracts on the last day of trading.

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[29] Notably, neither of the two examples cited in the Proposed Rule to justify the establishment of federal speculative position limits (*i.e.*, the Hunt Brothers and Amaranth Advisors L.L.C.) involved an exemption from speculative position limits being held in the last five days of trading. *See* Proposed Rule at 75,686 and n.70.

[30] The Working Group notes that any determination made by an Exchange with respect to the applicability of the Five-Day Rule to a requested Exemption would be subject to Commission oversight and review.

[31] *See* Supplemental Proposal at 38,478.

Further, an Exchange is in a position to analyze whether a commercial market participant holding an exemption for physical-delivery futures contract positions ***actually could*** make or take delivery of the expiring contract, even if that was not its primary objective, if liquidating its spot month position had the risk of creating a disorderly market condition. Commercial market participants can use existing inventory, access to storage assets or transportation capacity, as well as their purchase and sale obligations and market access to make or take delivery of the underlying physical commodity.[32] So, for example, a commercial market participant that is looking to hedge a jet fuel fixed-price purchase commitment with a short NYMEX ULSD position likely could deliver ULSD on the NYMEX contract in the event that liquidating the position in the last three days of trading posed a risk to the orderliness of the market (and the Exchange can evaluate this as a part of the application process as well as in monitoring the expiration of trading in the ULSD contract). This factor mitigates the risk that liquidation of a physical-delivery futures contract position during the spot month could disrupt the market.

For the foregoing reasons, the Working Group recommends that any final rule adopted by the Commission in this proceeding (i) does not apply the Five-Day Rule as an absolute restriction on the ability to hold a physical-delivery Referenced Contract in the spot month and (ii) confirms that the Exchanges have the appropriate discretion and authority to determine whether the facts and circumstances warrant recognition of an Exemption where a market participant seeks to hold a physical-delivery Referenced Contract in the spot month. To fully achieve the objectives underlying the proposed Exchange Exemption process provided in the Supplemental Proposal, the Commission should eliminate the Five-Day Rule from all hedges set forth in subsections (3)-(5) of the general BFH definition in proposed CFTC Regulation 150.1, which includes removing the Five-Day Rule from cross-commodity hedges.[33]

3. <u>The Proposed Application and Reporting Requirements Related to the Exchange Exemption Process Should Be Modified</u>.

a. *Proposed CFTC Regulation 150.3(a)(1)(iv).*

Proposed CFTC Regulation 150.3(a)(1)(iv) permits a market participant to receive an exemption from federal speculative position limits for "spread positions" recognized by an Exchange in accordance with proposed CFTC Regulation 150.10. Proposed CFTC Regulation 150.10 provides a list of spreads that may be approved by an Exchange, including calendar spreads, quality differential spreads, processing spreads, and product or by-product differential spreads. The Working Group submits that other types of spreads (*e.g.*, locational spreads) are utilized by commercial market participants to manage their physical risk exposures and provide

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[32] In addition, to avoid disorderly liquidation, physical market participants may utilize (i) the "exchange of futures for physical" ("**EFP**") mechanism or (ii) alternative delivery procedures ("**ADP**"), which generally are used when counterparties prefer not to perform under the exact terms of a futures contract. *See, e.g.*, NYMEX Rule 538; IFUS Rule 4.06; CME Rules 770-79.

[33] For further discussion about why the Five-Day Rule should be eliminated from all enumerated BFHs under proposed CFTC Regulation 150.1 and a list of specific provisions in the Proposed Rule from which the Five-Day Rule should be eliminated, see the March 30 Letter at 15-16 and Attachment 2, slides 14-28, August 4 Letter at 10, and February 10 Letter at 47-53.

liquidity to *bona fide* hedgers. Accordingly, the Working Group requests the Commission to clarify that the term "spread position" includes all types of spreads and the list of spreads referenced in proposed CFTC Regulation 150.10 is simply illustrative and not exhaustive.

b. *Proposed CFTC Regulations 150.9(a)(1)(v), 150.10(a)(1)(ii), and 150.11(a)(1)(v).*

For an Exchange to process applications for the Exemptions, proposed CFTC Regulations 150.9(a)(1)(v), 150.10(a)(1)(ii), and 150.11(a)(1)(v) require the Exchange to have at least one year of experience in administering exchange-set speculative position limits for the particular commodity derivative contract that underlies an Exemption application. The Working Group submits that these requirements would unnecessarily stifle innovation of new products in energy derivatives markets and prevent an Exchange from recognizing an Exemption under otherwise appropriate circumstances (*e.g.*, where there is a need to hedge in excess of applicable speculative position limits and there is liquidity in a new product that would justify such an exempted position).

As described above in Section II.A, the Exchanges generally have the experience, expertise, economic and regulatory incentives, as well as regulatory obligations under the Core Principles to manage the Exemption process effectively. They should be permitted to do so even if they have less than one year of experience in administering exchange-set speculative position limits for a particular derivative contract. To the extent that the Commission has concerns about the ability of the Exchanges to manage speculative position limits and Exemptions for newly developed Referenced Contracts, such concerns are more appropriately addressed through the CFTC's rule enforcement review process and general oversight.

Accordingly, the Working Group recommends that the Commission eliminate the requirements under proposed CFTC Regulations 150.9(a)(1)(v), 150.10(a)(1)(ii), and 150.11(a)(1)(v).

c. *Proposed CFTC Regulations 150.9(a)(3)(iii) and 150.10(a)(3)(iii).*

Proposed CFTC Regulations 150.9(a)(3)(iii) and 150.10(a)(3)(iii) require 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." Although the Supplemental Proposal notes that these proposed requirements are based on existing CFTC Regulation 1.47(b)(4), they appear to require a much broader set of information than is required to support the requested exemption. More likely, these proposed requirements were intended to apply only to positions in the contract for which an Exemption is sought and the final rule adopted in this proceeding should be amended in that manner. If proposed Regulations 150.9(a)(3)(iii) and 150.10(a)(3)(iii) indeed are intended to apply to an applicant's maximum size of all gross positions for each and every commodity derivative contract the applicant holds (as opposed to the maximum gross positions in the commodity derivative contract(s) for which the Exemption is sought), such requirements are unnecessary and unduly burdensome.

d. *Proposed CFTC Regulation 150.9(a)(3)(iv).*

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 an exemption. The Working Group submits that three years of historical data is unnecessary and provides little practical benefit in determining whether a requested NEBFH is appropriate. Under CFTC Regulations 1.47 and 1.48, no such requirement exists, and the Exchanges currently require an applicant to submit data on its cash market activity related to the requested NEBFH only for the previous year.

The submission of one year of data on an applicant's cash market activity is sufficient for the Exchanges and the Commission to verify that the applicant is legitimately engaged in the commercial activities for which the NEBFH is sought. The submission of data for a longer historical period has no incremental relevance to the applicant's expected future cash market activity. Further, the Exchanges[34] and the Commission have authority to seek additional historical data from an applicant if it is necessary in particular circumstances.[35]

Accordingly, the Working Group believes one year of cash market data for the year preceding the Exemption application is sufficient and should be adopted in the final rule.

e. *Proposed CFTC Regulations 150.9(a)(6), 150.10(a)(6), and 150.11(a)(5).*

Proposed CFTC Regulations 150.9(a)(6), 150.10(a)(6), and 150.11(a)(5) require an applicant to (i) file a report with the Exchange from which it receives recognition for an Exemption, identifying the applicant's offsetting cash positions or components of a spread, as applicable, and (ii) update and maintain the accuracy of such reports. On its face, these provisions appear to require a market participant to file reports for the Exemptions when the exempted position is initially established even if the relevant position does not exceed an applicable federal speculative position limit, and every time the applicant adjusts, lifts, or modifies a hedge position in accordance with changes in the market participant's cash market activity.[36]

Moreover, given many energy market participants hedge dynamically on a portfolio basis and may aggregate trading activity across several desks within and among several affiliates, including overseas affiliates, the Working Group submits that these requirements will be unduly burdensome, even if an applicant is required to file such reports only when it exceeds an applicable speculative position limit. The obligation to "update and keep accurate" such reports would appear to require an applicant to submit update reports any time its cash or derivatives positions change—potentially as often as every day.

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34 *See* proposed CFTC Regulations 150.9(a)(4)(ii); 150.9(d)(ii).

35 *See* CFTC Regulation 18.05 and proposed CFTC Regulation 150.3.

36 The Working Group submits that the information required in an Exemption application submitted to an Exchange will include highly sensitive, commercial information. The Working Group requests that the Commission confirm that such information will remain confidential and receive Freedom of Information Act ("**FOIA**") protections if provided to or accessed by the Commission.

The Working Group believes that any information or other data obtained through the reporting process contemplated by proposed CFTC Regulations 150.9(a)(6), 150.10(a)(6), and 150.11(a)(5) would be redundant, and consequently unnecessary, in light of (i) the requirements of proposed CFTC Regulations 150.9(a)(4)(i), 150.10(a)(4)(i), and 150.11(a)(3)(i) to reapply for an Exemption at least on an annual basis, including updates to submitted information, (ii) the real-time monitoring and surveillance conducted by the Exchanges for potential disruptions and manipulation in compliance with their Core Principles, (iii) the ability of the Exchanges to seek further information pursuant to their Commission-approved market rules from a market participant if they suspect potential speculative position limit violations, and (iv) the Commission's ability to seek further information related to an Exemption through its special call authority in proposed CFTC Regulation 150.3 and existing CFTC Regulation 18.05. The Working Group further submits that neither the Exchanges nor the Commission have the resources to analyze this information, much of which would not be material. Changes in position size for non-spot month contracts and modest position changes in the spot month contract likely would have no impact on the market and, therefore, should not raise concerns of excessive speculation.

Accordingly, the Working Group recommends that the Commission revise proposed CFTC Regulations 150.9(a)(6), 150.10(a)(6), and 150.11(a)(5) by requiring the Exchanges to adopt rules that would establish the requirements for the reporting of information related to Exemption applications as the Exchanges deem appropriate.[37] Specifically, the Working Group recommends that proposed CFTC Regulation 150.9(a)(6) be revised as follows.[38]

> (6) A designated contract market or swap execution facility that elects to process non-enumerated bona fide hedge applications shall file new rules or rule amendments pursuant to part 40 of this chapter, establishing or amending requirements for an applicant to file ~~a~~ report**s pertaining to the use of any such exemption that has been granted** ~~with such designated contract market or swap execution facility when such applicant owns or controls a derivative position that such designated contract market or swap execution facility has recognized as a non-enumerated bona fide hedge, and for such applicant to report the offsetting cash positions. Such rules shall require an applicant to update and maintain the accuracy of any such report.~~ **in the manner, form, and frequency, as determined by the designated contract market or swap execution facility.**

f. *The Proposed Application and Reporting Requirements Vastly Underestimate Costs to Market Participants*.

The Supplemental Proposal estimates the following costs to market participants seeking relief under the Exchange Exemption process: (i) for NEBFHs, $2,440 total average annual cost per market participant; (ii) for Spread Exemptions, $732 total average annual cost per market

[37] Such rules should not require the report to be filed unless a market participant has exceeded an applicable speculative position limit; nor should they require a market participant to identify specific NEBFHs being utilized.

[38] The Working Group recommends that proposed CFTC Regulations 150.10(a)(6) and 150.11(a)(5) be revised in a similar manner.

participant; (iii) for Anticipatory BFHs, $732 total average annual cost per market participant.[39] Notably, the cost estimates do not break out the costs for submitting an initial application and filing subsequent updates every time information in the application changes. Based upon its experience in submitting applications for Exchange exemptions, the Working Group submits that the Supplemental Proposal vastly understates the estimated costs to market participants seeking relief from federal speculative position limits under the proposed process.

The potential costs of complying with the proposed application and reporting requirements set forth in proposed CFTC Regulations 150.9, 150.10, and 150.11 should not be so high as to deter a market participant from seeking an Exemption from an Exchange or prevent a market participant from managing its risks efficiently. In this regard, the Working Group does not support the Supplemental Proposal's statement that if a market participant determines that the costs associated with seeking a proposed Exemption are too high and not worth the benefits, it simply has the option not to apply for such exemption or to execute a transaction that would exceed a speculative position limit.[40] The Working Group submits that the cost of that result—that commercial market participants would be unable to effectively hedge their physical exposures—must be measured against the benefits of the costly application and reporting requirements.[41]

Accordingly, the Working Group recommends that the Commission appropriately tailor its Exemption application and reporting requirements as recommended above in this Section II.B.3.

4. <u>The Commission Should Permit an Exchange to Recognize an Exemption after a Market Participant Has Exceeded an Applicable Speculative Position Limit if the Exchange Finds the Facts and Circumstances Warrant Such Exemption</u>.

Under current practice, the Exchanges currently will not deem a market participant in violation of an applicable speculative position limit if the market participant files an exemption application within five days of exceeding an applicable speculative position limit.[42] This flexibility allows for a sudden and unexpected change in a market participant's underlying commercial business. It also allows an Exchange to approve an exemption where the circumstances warrant such action, such as where a market participant inadvertently exceeded a speculative position limit with a non-speculative position for which an exemption would have been available had an application been timely filed.

Consistent with this current practice and the spirit of the Supplemental Proposal, the Working Group recommends that the Commission provide the Exchanges discretion to approve an Exemption after a market participant has exceeded an applicable speculative position limit if

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39 *See* Supplemental Proposal, Tables D1, D2, and C3.

40 *See* Supplemental Proposal at 38,488, 38,493.

41 *See* Supplemental Proposal at 38,493.

42 *See, e.g.*, NYMEX Rule 559, IFUS Rule 6.13.

the Exchanges find it appropriate. Such recommendation does not modify or alter the Commission's existing authority to monitor the Exchanges' use of this flexibility under (i) the proposed Part 150 regulations or (ii) existing the rule enforcement review process.

5. The Exchanges Should Not Be Bound to the Same Exemption Process Provided Under Proposed CFTC Regulation 150.9 When Administering Exemptions from Exchange-Set Limits.

Proposed CFTC Regulation 150.5(b)(5)(i) states that, if an Exchange adopts any hedge exemption rules for exchange-set speculative position limits, such rules must conform to the BFH definition in proposed CFTC Regulation 150.1 or provide for NEBFH recognition "***in a manner consistent with*** the process described in [proposed CFTC Regulation] 150.9(a)" (emphasis added). If not clarified, the Working Group is concerned that this requirement could be interpreted to mean that the ***virtually identical*** regulatory framework for, and legal standards applicable to, exemptions for NEBFHs from federal speculative position limits would be applied to exemptions from exchange-set speculative position limits.

If that is the intent of the Supplemental Proposal, this requirement severely undercuts the Exchanges' historical practice in administering exemptions from exchange-set speculative position limits in accordance with their market expertise, experience, and internal resources. Further, this requirement would represent a significant departure from the requirements currently applicable to the Exchanges with respect to exchange-set speculative position limits notwithstanding the Supplemental Proposal largely is intended to address exemptions only from federal speculative position limits. It is also unclear whether the Supplemental Proposal's cost-benefit analysis assesses the appropriateness of such requirement on exchange-set speculative position limits or includes the costs of processing NEBFHs and Spread Exemptions for contracts subject only to exchange-set speculative position limits and not federal speculative position limits.

The Working Group recommends that the Commission (i) not adopt proposed CFTC Regulation 150.5(b)(5)(i) in any final rule issued in this proceeding or (ii) clarify that the phrase "in a manner consistent with the process described in [proposed CFTC Regulation] 150.5(b)(5)(i)" does not mean that the Exchanges must apply the virtually identical process for recognizing NEBFHs under proposed CFTC Regulation 150.9(a) to their exemption process for exchange-set speculative position limits.

C. Certain Portions of the December 2013 Proposed Rule Must Be Revised in Light of the Supplemental Proposal.

Although the Supplemental Proposal addresses several important concerns raised in the course of this proceeding, many issues in the Proposed Rule remain. The Working Group sets forth below certain existing concerns under the Proposed Rule and incorporates by reference the substantive comments submitted in its Comment Letters. In addition, the Working Group also provides for ease of reference Attachment 1 appended hereto presenting a summary of all the new and remaining issues presented by the Proposed Rule or the Supplemental Proposal. The Working Group urges the Commission to review the comments presented herein together with the Comment Letters before adopting any final rule in this proceeding.

1. The "Economically Appropriate Test" and Proposed Form 204 Should Reflect How Commercial Market Participants Actually Manage Their Risks.

The new, proposed interpretation of the phrase "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise" provided in the BFH definition under proposed CFTC Regulation 150.1 (the "**Economically Appropriate Test**") and the proposed Form 204 filing requirements for persons that exceed federal speculative position limits suffer from the same defect. That is, they both require a commercial enterprise to include and consider for purposes of *bona fide* hedging portions of its commodity portfolio that it would not otherwise consider in managing risk in the regular course of its business.

Commercial firms manage risks in a variety of ways as particular risks or circumstances dictate. As explained in the Comment Letters,[43] risks sometimes are managed in the aggregate (as the proposed Economically Appropriate Test would require), or frequently, are separately managed on a legal entity, division, trading desk, trader, or asset basis (none of which would be permitted under the proposed Economically Appropriate Test).

By way of example, to pass the Economically Appropriate Test, a commercial enterprise that held production assets and a refinery and currently managed each as a separate profit center with separate day-to-day goals, objectives, and management would not be permitted to manage the risks of production separately from the risks of refining. A long physical crude oil exposure in the production unit would be required to "offset" a short exposure in the refinery operation to determine if a derivative used to reduce risk of production or refining "reduced risk to the commercial enterprise" even if one had nothing to do with the other in any risk management sense whatsoever (*i.e.*, the producer supplied in a different location than the location of the refiner, or the producer supplied and the refinery sourced competitively from independent third-parties, or the producer generally sold at spot prices and the refiner purchased crude oil through long-term fixed price supply deals). Further, proposed Form 204 would require the commercial market participant to report the physical position in crude oil of both its production and refining arms, providing the Commission with irrelevant information that would fail to allow the Commission to achieve its apparent goal of testing whether the hedge was actually risk-reducing.

Numerous other examples (some of which are in the Comment Letters) demonstrate the failings of the proposed Economically Appropriate Test and the Form 204. As the former requires consideration of all inventory and fixed-price commitments and the latter requires a report of all stocks and fixed-price commitments in the commodity underlying the hedge, a market participant with natural gas in storage in California (perhaps used to supply its own power plant) would be required to offset the price risk of that natural gas against a fixed-price sales contract in the Gulf Coast that its merchant division had entered into, even if it had no commercial reason to manage its risks in that manner. The market participant would be required to report on proposed Form 204 both the inventory and fixed-price sales positions, even if only

[43] *See* February 10 Letter at 11-14; August 4 Letter at 6-8; March 30 Letter at 11-14.

one exposure was the basis for a hedging decision. Likewise, assume that the inventory was crude oil in Africa or that the sales obligation was a term deal that included price risks of an entirely different time horizon from inventory.[44] If it was not part of the entity's regular course of business in prudently managing its risks to consider the crude oil in Africa in deciding whether to hedge the sales commitment, there is no value in requiring the entity to do so to determine if a hedge of a longer term U.S. sales agreement was "economically appropriate" or to report that inventory to the Commission.

In each of these cases and many others, the Economically Appropriate Test would require a commercial market participant to manage risks in a government mandated manner that does not reflect current (or prudent) risk management practices. Proposed Form 204 also would require that market participant to track and report to the Commission inventory and fixed-price contracts that bore no relation to the market participant's actual risk management practices—an extraordinary burden for an active, global commercial market participant—and would serve no useful function.

The Working Group urges the Commission to impose the concept already embodied in Part 19 of the Proposed Rule, namely, that to satisfy the Economically Appropriate Test a market participant must consider "all inventory and fixed-price commitments associated with the Core Referenced Futures Contract for which it claims an exemption that it deems relevant in the

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[44] The example provided in the Proposed Rule of how the new, proposed Economically Appropriate Test would work, demonstrates how the overly simplistic nature of the concept fails to address risk management realities. Specifically, the Proposed Rule provides:

> By way of example, a merchant may have sold a certain quantity of a commodity for deferred delivery in the current year (*i.e.*, a fixed-price cash sales contract) and purchased that same quantity of that same commodity for deferred receipt in the next year (*i.e.*, a fixed-price cash purchase contract). Such a merchant would be exposed to value risks in the two cash contracts arising from different delivery periods (that is, from a timing difference). Thus, although the merchant has bought and sold the same quantity of the same commodity, the merchant may elect to offset the price risk arising from the cash purchase contract separately from the price risk arising from the cash sales contract, with each offsetting commodity derivative contract regarded as a bona fide hedging position. However, if such a merchant were to offset only the cash purchase contract, but not the cash sales contract (or vice versa), then it reasonably would appear the offsetting commodity derivative contract would result in an increased value exposure of the enterprise (that is, the risk of changes in the value of the cash commodity contract that was not offset is likely to be higher than the risk of changes in the value of the calendar spread difference between the nearby and deferred delivery period) and, so, the commodity derivative contract would not qualify as a bona fide hedging position.

See Proposed Rule at 75,709.

This suggests that a prudent risk manager could not consider the innumerable supply/demand fundamentals that might give the nearby commitment an entirely different risk profile from the more distant commitment, including subjectively perceived differences, such as potential political or economic developments or known, factual distinctions, such as seasonal differences or scheduled pipeline outages. Any different supply/demand fundamentals should and would be considered by a prudent risk manager. But if consideration of all supply/demand fundamentals led to a decision by the risk manager to fully hedge one risk and only partially hedge the other (or not at all), such risk management position would fail the Economically Appropriate Test and would not qualify for a BFH exemption.

regular course of its business." Additionally, to satisfy Form 204 reporting obligations under Part 19 of the CFTC's Regulations, the Commission should require a market participant to report "such inventory and fixed-price obligations that it considered in the regular course of its business in managing risks by using the Core Referenced Futures Contract for which it claims an exemption."[45]

2. Form 204 Reporting Requirements Should Be Clarified and More Appropriately Tailored to Maximize their Utility to Both Market Participants and the Commission.

The Working Group believes the Commission should retain its existing Form 204 for purposes of reporting to the Commission enumerated BFHs, as it is more appropriately tailored than the proposed Form 204 set forth in the Proposed Rule. However, the Working Group recommends that the Commission make certain modifications to existing Form 204, as described below.

What to Report. For each Referenced Contract in which the Form 204 filer holds a position which qualifies for an exemption from speculative position limits, the filer should be required to report the following:

- **Part I.** Report in equivalent Core Referenced Futures Contract units the aggregate quantity of cash positions that underlie bona fide hedge positions. If it is part of the filer's regular business practice to exclude all or part of the actual commodity, certain source commodities, products, or byproducts in determining its cash positions for bona fide hedging, they should be excluded and not reported as part of Form 204.

- **Part II.** If the filer included "cross-hedged" cash commodities in Part 1 of the Form 204, the filer must also report the aggregated quantity of bona fide hedge positions it is cross hedging in terms of the actual commodity. The filer also should specify the futures market in which it is hedging.

[45] The Working Group understands that the Commission may be concerned that a party could "game" the system by including and excluding risks on the Form 204 in an opportunistic manner that would not provide an accurate picture of whether a derivative contract actually reduced risk or increased risk to the commercial enterprise. The Working Group submits that such concern should be minimal. Each Form 204—which represents that the claimed position satisfies the standard under CFTC Regulation 150.1—will be signed under oath and subject to the prohibition against false statements under CEA Section 9(a)(3). Further, if the CFTC is dissatisfied with a Form 204 submission or suspects wrongdoing, it may request additional information from a market participant submitting a Form 204 or deny a claimed exemption if the information provided is unsatisfactory pursuant to: (i) the CFTC's special call authority under existing CFTC Regulation 18.05 and proposed CFTC Regulation 150.3; (ii) the CFTC's anti-disruptive trading practices authority under CEA Section 4c(a)(5); or (iii) the CFTC's anti-fraud and anti-manipulation authority under CEA Sections 6(c)(a) and 9(a).

"As of" Date. Cash market information should be required to be reported as of the close of business on the day prior to the first day on which the spot month for the applicable Core Referenced Futures Contract starts. Existing Form 204 requires information to be submitted as of the close of business on the last Friday of the month, which would provide little, if any, useful information to the Commission given spot months for energy Referenced Contracts may not include the last Friday of the calendar month. A hedger's cash position immediately preceding commencement of the spot month represents the most relevant exposure from which the Commission may determine whether an enumerated BFH exemption is warranted.

Reporting Date. Form 204 should be required to be filed no later than the 15th day of any month (or first business day thereafter) following a month in which a party exceeded a federal speculative position limit, which would allow the market participant sufficient time to collect, analyze, and report the hedged cash commodity information.

Finally, the Working Group recommends that the Commission issue guidance akin to the guidebook published for Large Trader Reporting under Part 20 of the CFTC's Regulations,[46] to aid market participants in their attempts to build systems to identify and collect information that must be provided in the Series '04 reports.[47]

3. Trade Options.

a. *Trade Options Should Be Exempt from Federal Speculative Position Limits.*

As discussed in the February 10 Letter, the Working Group does not believe that trade options should be subject to federal speculative position limits.[48] A trade option by definition must relate to an offeree's commercial business, and consequently, cannot function as a speculative derivative or give rise to excessive speculation. Importantly, the CFTC's final rule on trade options indicated that the CFTC did not believe federal speculative position limits should apply to trade options and noted that the CFTC would address the treatment of trade options for purposes of federal speculative position limits under this proceeding.[49] Accordingly, consistent with the CFTC's statements in the Final TO Rule, the Working Group reiterates its

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[46] If the CFTC declines to adopt the Working Group's recommendations provided above in Sections II.C.1-2, significant uncertainty in the scope and applicability of certain terms provided in proposed CFTC Regulation 19.01(a)(3) (*i.e.*, "commodity hedged," "products and byproducts") will exist among participants in energy commodity markets and CFTC staff members. For example, in a hedge of physical crude oil using NYMEX Light Sweet Crude Oil (CL) futures contract, the term "commodity" set forth in proposed CFTC Regulation 19.01(a)(3) could mean: (i) the fourteen grades of crude oil that are listed as being deliverable under the NYMEX CL contract, including Brent crude; (ii) all grades of light sweet crude that can be delivered to Cushing, Oklahoma; (iii) all grades of light sweet crude, including those not deliverable to Cushing, Oklahoma; or (iv) all grades of crude oil, including sour and heavy crude oil.

[47] *See* Large Trader Reporting for Physical Commodity Swaps: Division of Market Oversight Guidebook for Part 20 Reports, *available at* http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/ltrguidebook062215.pdf.

[48] *See* February 10 Letter at 55-58.

[49] *See Trade Options*, Final Rule, 81 Fed. Reg. 14,966, 14,971 (Mar. 21, 2016) ("**Final TO Rule**").

recommendations provided in the February 10 Letter that any final rule adopted in this proceeding should expressly exempt trade options from federal speculative position limits.[50]

b. *The Hedge of a Trade Option Should Be Permitted to Receive a BFH Exemption*.

Because the CFTC interprets the definition of "swap" under CEA Section 1a(47) to include trade options, the Working Group is concerned that the Commission would not provide BFH treatment to a derivatives position hedging the risks associated with a trade option. The BFH definition provided under CEA Section 4a(c) generally requires a derivatives transaction or position to be hedging a market participant's physical risk or exposure. Trade options are entered into frequently in physical energy commodity markets and create physical exposures for market participants entering into them. Notwithstanding their legal characterization as a swap, trade options are physical contracts, and if exercised, will result in the physical delivery of a commodity related to the offeree's commercial business. Trade options play a critical role in energy commodity markets, ensuring the availability of a commodity if it is needed or if another source of supply fails. If market participants are unable to receive BFH treatment for derivatives positions hedging the risks associated with trade options, they will be unable to effectively manage the risks associated with their physical businesses.

Accordingly, the Working Group recommends that the Commission clarify that a Referenced Contract used to hedge the risks associated with a trade option should be eligible for a BFH exemption notwithstanding a trade option's legal status as a swap.[51]

4. Timing of Implementation.

The Working Group requests that the Commission establish a compliance date for spot month federal speculative position limits and accountability levels[52] nine months from the date that the Exchanges adopt Commission-approved rules implementing the Exemption process. While energy market participants currently comply with exchange-set speculative position limits rules and exemptions, new informational technology systems and business practices must be developed and implemented to comply with the regulatory differences under the federal speculative position limits framework, including the Exchange Exemption process, which will require a new process for market participants seeking NEBFH and Spread Exemptions.

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[50] For a more thorough discussion supporting this recommendation, see the February 10 Letter at 55-58.

[51] *See* February 10 Letter at 55-58.

[52] The Working Group recommends that the CFTC adopt accountability levels rather than non-spot month federal speculative position limits and permit the Exchanges to administer such accountability levels. *See* March 30 Letter at 8-10; February 10 Letter at 60-63. If the CFTC declines to adopt the Working Group's recommendations and adopts non-spot month federal speculative position limits, the Working Group recommends that the Commission establish a compliance date for such speculative limits at least twelve months from the date the Exchanges adopt Commission-approved rules implementing the Exemption process.

5. End-of-Day[53] Compliance with Federal Speculative Position Limits.

The Proposed Rule would require federal and exchange-set speculative position limits to be complied with on an intraday basis. The Working Group recognizes that existing federal and exchange-set speculative position limits must be complied with on an intraday basis. However, distinct from the current regulatory framework, the Proposed Rule vastly broadens the scope of commodity derivative contracts that will be subject to federal speculative position limits. Specifically, if adopted as proposed, federal speculative position limits would apply across markets and cover not only futures and options on futures, but also swaps, including over-the-counter swaps, financial options, swaptions and other products that fall within the definition of Referenced Contract. Aggregating positions across markets for all exchange-traded and over-the-counter Referenced Contracts for purposes of complying with one federal speculative position limit on an intraday basis will prove very complex and burdensome, especially for companies that will have to aggregate positons across U.S. and non-U.S. affiliates.

Accordingly, the Working Group requests that the Commission apply federal speculative position limits on an end-of-day basis, such that a market participant would not be in violation of a federal speculative position limit if the market participant exceeds an applicable speculative position limit during the day but exits positions to come below the applicable speculative position limit by the end of day.

III. SPECIFIC RESPONSES TO THE CFTC'S RFCS SET FORTH IN THE SUPPLEMENTAL PROPOSAL.

RFC 8: If the Commission permits NEBFH positions to be held into the spot month, should recognition of NEBFH positions be conditioned upon additional filings to the exchange—similar to the proposed Form 504 filings required for the proposed conditional spot month limit exemption? As proposed, Form 504 would require additional information on the market participant's cash market holdings for each day of the spot month period. Under this alternative, market participants would submit daily cash position information to the exchanges in a format determined by the exchange, which would then be required to forward that information to the Commission in a process similar to that proposed under § 150.9(c)(2).

RFC 9: Alternatively, if the Commission permits NEBFH positions to be held into the spot month, should the Commission require market participants to file the Form 504 with the Commission? Under this alternative, the relevant cash market information would be submitted directly to the Commission, eliminating the need for the exchange to intermediate, although the Commission could share such a filing with the exchanges. The Commission would adjust the title of the Form 504 to clarify that the form would be used for all daily spot month cash position reporting purposes, not just the proposed requirements of the conditional spot month limit exemption in proposed § 150.3(c). Consistent with the restrictions regarding the offset of risks arising from a swap position in CEA section 4a(c)(2)(B), proposed § 150.9(a)(1) would not permit an exchange to recognize an NEBFH involving a commodity index contract and one or

[53] For purposes of complying with federal speculative positon limits, the Working Group submits that "end-of-day" means 11:59 PM Eastern Time.

more referenced contracts. That is, an exchange may not recognize an NEBFH where a bona fide hedge position could not be recognized for a pass through swap offset of a commodity index contract.

RFC 21: If the Commission permits exchanges to grant spread positions applicable in the spot month, should recognition of NEBFH positions be conditioned upon additional filings similar to the proposed Form 504 that is required for the proposed conditional spot month limit exemption? Proposed Form 504 would require additional information on the market participant's cash market holdings for each day of the spot month period. Under this alternative, market participants would submit daily cash position information to an exchange in a format determined by the exchange, which would then be required to forward that information to the Commission in a process similar to that proposed under § 150.10(c)(2).

RFC 22: Alternatively, if the Commission permits exchanges to grant spread exemptions applicable in the spot month, should the Commission require market participants to file proposed Form 504 with the Commission? Under this alternative, the relevant cash market information would be submitted directly to the Commission, eliminating the need for the exchange to intermediate. The Commission would adjust the title of proposed Form 504 to clarify that the form would be used for all daily spot month cash position reporting purposes, not just the proposed requirements of the conditional spot month limit exemption in proposed § 150.3(c).

Working Group Responses to RFCs 8, 9, 21, and 22: As described above in Section II.B.2, the Working Group recommends that the Commission permit the Exchanges to recognize NEBFHs and Spread Exemptions held into the spot month. The Working Group also recommends that the Commission not adopt any additional reporting requirements, including daily cash reporting in the spot month, should the Commission permit Exchanges to recognize NEBFHs and Spread Exemptions in the spot month. As described above in Section II.B.3, the Exemption application and reporting requirements should be narrowly tailored, and as proposed, already are unnecessarily burdensome and do not pass a cost-benefit test.

RFC 26: If the proposed rules do not prohibit such exemptions, an exchange could determine that cash-and-carry spread exemptions—or another type of spread exemption—further the policy objectives in proposed § 150.10(a)(3) and so begin to grant such exemptions from federal position limits. If, after finishing its review, the Commission disagrees with the exchange's determination, is the proposed process in § 150.10(d) for reviewing exemptions sufficient to address any concerns raised?

Working Group Response to RFC 26: The Working Group believes the Exchanges should have full discretion to grant Spread Exemptions based on their review of any applicable facts and circumstances. *See* Section II.A, above. The Working Group submits that the process in proposed CFTC Regulation 150.10(d) for reviewing Exchange determinations is sufficient.

RFC 27: Does the application process solicit sufficient information for an exchange to consider whether a spread exemption would, to the maximum extent practicable, further the policy objectives of CEA section 4a(a)(3)(B)? For example, how would an exchange determine whether an applicant for a spread exemption may provide liquidity, such that the goal of ensuring sufficient market liquidity for bona-fide hedgers would be furthered by the spread exemption?

Working Group Response to RFC 27: An Exchange should not be required to determine whether liquidity will be increased if a particular Spread Exemption is granted before it is permitted to grant such Spread Exemption. This requirement effectively would create an entirely new legal standard for Spread Exemptions and flip on its head the requirement under CEA Section 4a(a)(3)(B)(iii), which states that, to the maximum extent practicable, ***in establishing speculative position limits*** the Commission in its discretion should ensure sufficient market liquidity for *bona fide* hedgers. CEA Section 4a(a)(3)(B)(iii) does not require (and should not require) that, in granting an exemption from speculative position limits, the exemption must add to liquidity. Although, the Working Group notes that, almost by definition, the grant of an exemption from a speculative position limit will increase open interest and consequently, liquidity.

RFC 31: The Commission invites comments on its proposed delegation of authority in § 150.11(e)(iv), and on all other aspects of its proposed delegation of authority in § 150.9(f), § 150.10(f) and § 150.11(e).

Working Group Response to RFC 31: The Working Group supports the Commission's delegation of authority in the provisions referenced in RFC 31 only if the Commission, not DMO, retains the ultimate decision on whether to grant or reject an Exemption. The Working Group recommends that the Commission clarify the delegation provisions referenced in RFC 31 by expressly stating that the Commission, not DMO, now and always will retain the ultimate authority to grant or deny Exemption applications.

RFC 32: The Commission invites comment on all aspects of its proposed expanded definitions of "intermarket spread position" and "intramarket spread position."

Working Group Response to RFC 32: The Commission should clarify that the term "spread positions" includes all types of spreads, including locational spreads, and that the list provided in the preamble of the Supplemental Proposal as well as proposed CFTC Regulation 150.10(a)(2) is illustrative and not exhaustive. *See* Section II.B.3.a, above.

RFC 37: The Commission recognizes that there exist alternatives to the proposed definition of ''bona fide hedging position.'' These alternatives include: (i) Maintaining the status quo in current § 1.3(z), or (ii) pursuing the changes in the December 2013 position limits proposal. Are there additional alternatives that the Commission has not identified? If so, please describe these additional alternatives and provide a discussion of the associated qualitative and quantitative costs and benefits.

Working Group Response to RFC 37: The Working Group has provided an extensive amount of discussion on alternatives to the proposed definition of "bona fide hedging" through comment letters, roundtable, EEMAC, and other CFTC meetings posted to its web site. The Working Group's recommendations would prevent an unnecessary disruption of existing commercial risk management practices in the energy industry and ultimately prevent an increase in consumer prices.

RFC 66: Are there any other public interest considerations that the Commission should consider?

Working Group Response to RFC 66: The Commission should place greater weight on the public interest and benefit in eliminating restrictions that would limit effective risk management (which would result in lower consumer prices). Extra risk in the physical commodity supply chain ultimately will be borne by consumers through increased costs.

IV. CONCLUSION.

The Working Group supports appropriate regulation that brings transparency and stability to the physical commodity and derivatives markets. The Working Group appreciates this opportunity to provide comments on the Supplemental Proposal and requests that the Commission consider the comments set forth herein as it develops any final rule in this proceeding.

The Working Group expressly reserves the right to supplement these comments as deemed necessary and appropriate. If you have any questions, please contact the undersigned.

Respectfully submitted,

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ATTACHMENT 1

THE COMMERCIAL ENERGY WORKING GROUP
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ISSUES THAT SHOULD BE ADDRESSED BEFORE FINALIZING A SPECULATIVE POSITION LIMITS RULE

PART 19

19.00 GENERAL PROVISIONS

1. To satisfy Form 204 reporting obligations under Part 19, a market participant must report "such inventory and fixed-price obligations that it considered in the regular course of its business in managing risks by using the Core Referenced Futures Contract for which it claims an exemption." *See* July 13 Letter,[54] Section II.C.1-2, p. 15-18; March 30 Letter,[55] Section III.C.7, p. 16-18.

19.01 REPORTS ON STOCKS AND FIXED PRICE PURCHASES AND SALES

2. ***Form 504 (Section 19.01(a)(1))***. Form 504 is unnecessary if the Commission adopts the Working Group's suggestion to eliminate the condition associated with the proposed conditional limit. If the Commission, however, adopts the proposed conditional limit as is, the Form 504 should simply require an affirmative representation that a market participant is utilizing the conditional exemption and that they do not hold any physical-delivery Referenced Contracts. *See* February 10 Letter,[56] Section XIII.B, p. 65-66.

3. ***Form 204 (19.01(a)(3))***. The Commission should adopt a good faith standard that provides market participants with a reasonable degree of flexibility when verifying the accuracy of Form 204 submissions. *See* February 10 Letter, Section XIII.A, p. 64-65.

   The Commission also should adopt in any final rule adopted in this proceeding existing Form 204 with certain modifications as set forth in the July 13 Letter, Section II.C.2, and issue guidance akin to the guidebook published for Large Trader Reporting under Part 20 of the CFTC's Regulations. *See* July 13 Letter, Section II.C.2, p. 17-18.

PART 150

150.1 DEFINITIONS

Basis Contracts

4. The definition of "basis contract" set forth in the Proposed Rule should include the following sets of commodity derivative contracts:

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[54] *See* The Commercial Energy Working Group, *Comment Letter Re: Position Limits for Derivative: Certain Exemptions and Guidance*, RIN 3038-AD99 (July 13, 2016) ("**July 13 Letter**").

[55] *See* The Commercial Energy Working Group, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (Mar. 30, 2015) ("**March 30 Letter**").

[56] *See* The Commercial Energy Working Group, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (Feb. 10, 2014) ("**February 10 Letter**").

- Any commodity priced at a differential to any of its products and by-products, such as a crude oil crack spread contract, which represents the difference in prices between crude oil and gasoline blendstock (reformulated blendstock for oxygenate blending or "RBOB") or ultra low sulfur diesel ("ULSD");

- A product or byproduct of a particular commodity, priced at a differential to another product or byproduct of that same commodity, such as a contract based on jet fuel priced at a differential to heating oil; both of which are manufactured from crude oil, and

- A particular commodity that includes other similar commodities, such as a contract based on the difference in prices of light sweet crude oil and a sour crude oil that is not deliverable under the WTI contract.

See August 4 Letter,[57] Section IV, p. 15-17; February 10 Letter, Section XIV.C, p. 68.

"*Bona Fide* Hedging Position"

"Economically Appropriate Test" (Subsection (2)(i)(B))

5. The Commission is proposing a new interpretation of the Economically Appropriate Test which substitutes an inappropriate "one-size-fits-all" standard for risk management in place of individualized business practices utilized in the energy industry. The Working Group urges the Commission to impose the concept already embodied in Part 19 of the Proposed Rule, namely, that to satisfy the Economically Appropriate Test a commercial market participant must consider "all risks associated with the Core Referenced Futures Contract for which it claims an exemption that it deems relevant in the regular course of its business." *See* July 13 Letter, Section II.C.1, p. 15-17; March 30 Letter, Section III.C.2, p. 11-14; August 4, 2014 Letter, Section III.A, p. 6-8; February 10 Letter, Section III.A, p. 11-14.

Non-Enumerated Bona Fide Hedging Positions ("**NEBFHs**") (Subsection (2)(i)(D)(2))

6. The Working Group supports the utilization of the Exchanges to recognize NEBFHs, but the Commission should ensure the Exchanges have full discretion and flexibility to recognize NEBFHs by (i) refraining from making any determination that a non-enumerated risk-reducing transaction does not meet the general criteria of the BFH definition and (ii) removing the Five-Day Rule from any *bona fide* hedge definition provision under proposed CFTC Regulation 150.1 and delegating the authority to the Exchanges to determine whether a physical-delivery Referenced Contract held in the spot month should receive an exemption from federal speculative position limits. *See* July 13 Letter, Sections II.A-B.2, p. 2-9.

Five-Day Rule Applicable to Pass-Through Swaps and Enumerated BFHs (Subsections 2-4)

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

7. The Commission should eliminate the Five-Day Rule from all provisions of the definition of "*bona fide* hedging position" and allow the Exchanges to determine whether an exemption should be granted to a physical-delivery Referenced Contract in the spot month.

   See July 13 Letter, Section II.A-B.2, p. 2-9; February 10 Letter, Section VII, p. 51-53.

Enumerated Exemptions for *Bona Fide* Hedging Positions (Subsections (3)-(4))

8. ***Merchandising and Anticipated Merchandising***. The Commission should expand the list of enumerated *bona fide* hedge positions to encompass the following commonly-utilized, non-speculative activity:

   (a) anticipated purchases and sales, where a merchandiser has a demonstrable history of buying, transporting, storing, blending, or selling the commodity;

   (b) floating price commitments, where a party has purchased (or sold) a commodity at a floating price with the intention that it will sell (buy) the commodity at a floating price;

   (c) bids and offers that are binding and will require the party to make or take delivery at a stated, fixed price;

   (d) the value of assets, such as energy infrastructure, owned or anticipated to be owned;

   (e) the value of storage that a party owns, leases or anticipates owning or leasing, as reflected in the price of anticipated purchases to fill the storage and associated sales from storage;

   (f) the value of transportation services that a party owns, leases or anticipates owning or leasing, as reflected in the price of anticipated purchases in one location and sales in another;

   (g) unfixed price commitments, where a party has purchased (or sold) a commodity at a floating price, and the party wants to lock in the differential that covers its costs and eliminate risk in its ability to sell (or buy) the physical product at the same index; and

   (h) unfixed price commitments used to ensure supply or outlet for products that will be purchased or sold before or through the spot month.

   - The Commission should provide *bona fide* hedging treatment to hedges of unfixed price commitments used to ensure supply or outlet for products, and permit such hedges to be held through the spot month under this treatment. *See* March 30 Letter, Section III.C.5, p.15-16.

   See March 30 Letter, Section III.C.4-6, p. 15-16, and Attachment 2; August 4 Letter, Section II.A.3, p. 5-6; February 10 Letter, Section IV.B, p. 16-26.

9. ***Unfixed Priced Requirements and Unfixed Priced Production***. The Commission should revise the definition of "*bona fide* hedging position" to allow a party that has the need to hedge anticipated requirements or production to lock in the price in instances where it has contracted to purchase its requirements or sell its production but at a floating price. *See* August 4 Letter, Section II.A.3, p. 5-6; III.C, p. 10-14; February 10 Letter, Section IV.D, p. 26-27.

10. ***Utility Hedging Unfilled Anticipated or Unfixed Priced Requirements for Customers***. The Commission should revise subsection 3(iii)(B) of the definition of "*bona fide* hedging position" to apply to "hedges of unfilled anticipated or unfixed priced requirements for customers" and permit a utility or other similar entity designated as a sole provider or a provider of last resort to its customers to claim the exemption. *See* March 30 Letter, Attachment 2, slides 11-13; February 10 Letter, Section IV.E, p. 27-28.

11. ***Calendar Month Average Pricing***. Calendar month average pricing is used to lock in a pricing formula for producers and users of energy products and the parties that buy from or sell to them. That practice should be recognized as an enumerated *bona fide* hedge position set forth in proposed CFTC Regulation 150.1. *See* March 30 Letter, Attachment 2, slides 14-28; August 4 Letter, Section III.C, p. 10-14; February 10 Letter, Section IV.G, p. 29-37.

    - Further, the Commission should provide *bona fide* hedging treatment to Referenced Contracts that convert transaction pricing terms to CMA pricing and permit these Referenced Contracts to be held through the spot month under this treatment. *See* March 30 Letter, Attachment 2, slides 14-28.

12. ***Heat Rate Transactions in Electricity Markets***. The Commission should recognize as an enumerated hedge under subsection (3) of the definition of "*bona fide* hedging position" a position in a Referenced Contract used to hedge a transaction in a different commodity that is priced by reference to the commodity underlying the Referenced Contract, (ii) exclude from position limits heat rate derivatives, which are spread contracts, or (iii) modify proposed subsection (5) of the definition of "*bona fide* hedging position" to include as *per se* cross-commodity hedges heat rate transactions and electricity and natural gas transactions used to hedge physical heat rate transactions. *See* March 30 Letter, Section III.C.3, p. 14-15; February 10 Letter, Section VIII, p. 53-55.

13. ***Anticipated Cash Transactions Subject to Ongoing Good Faith Negotiations***. The Commission should expand the *bona fide* hedge definition to address anticipated cash transactions where a market participant has a good faith, reasonable belief that such transactions will be consummated. *See* August 4 Letter, Section III.C, p. 10-14; February 10 Letter, Section IV.C, p. 26.

14. ***Commodity Transactions Priced as Differentials***. The CFTC should expand the *bona fide* hedge definition to address hedging transactions that involve a differential between (i) locations, grades or qualities of two or more commodities, or (ii) a commodity (*i.e.*, electricity) and a fuel source (*i.e.*, natural gas), that arises from a

fixed price differential in one or more transactions. *See* February 10 Letter, Section XV, p. 68-70.

Cross-Commodity Hedges, Including Five-Day Rule (Subsection (5))

15. A quantitative test for determining whether a cross-commodity hedge qualifies for regulatory treatment as a "*bona fide* hedging position" is unnecessary and unworkable. The CFTC should adopt a qualitative test. *See* August 4 Letter, Section III.B, p. 8-10; February 10 Letter, Section VI, p. 37-51.

16. The Commission should recognize that natural gas Referenced Contracts often provide the best available mechanism to hedge price and operational risk associated with long-term power transactions. *See* March 30 Letter, Section III.C.3, p. 14-15; February 10 Letter, Section VI.A.2, p. 41-46. In the same manner, the Commission should recognize other potential "cross-commodity" relationships that are commonly used by commercial energy market participants to reduce their exposure to price risk. *See* February 10 Letter, Section VI.A.3, p. 46-47 and Attachment 1 appended thereto (setting forth a non-exclusive list of cross-commodity relationships, other than natural gas and power, commonly utilized by commercial hedgers in the energy sector).

17. The Commission should revise subsection (5) of the definition of "*bona fide* hedging position" to permit market participants to hold a physical-delivery Referenced Contract into the spot month as a *bona fide* hedging position where (i) such position is necessary to hedge the risk of commodities that are being delivered or priced in the spot month, or (ii) where the commodities represent components that, if blended together (or in concert with other components), represent the deliverable grade of the underlying commodity derivative contract. *See* July 13 Letter, Section II.B.2, p. 7-9; August 4 Letter, Section III.B, p. 10; February 10 Letter, Section VI.B, p. 47-51. At a minimum, it should remove the Five-Day Rule and let the Exchanges determine whether a cross-commodity hedge in the spot month should receive an exemption from federal speculative position limits. *See* July 13 Letter, Section II.B.2, p. 7-9.

18. The Commission should clarify that when a physical transaction is priced with reference to the commodity underlying a Referenced Contract, the hedge transaction in the Referenced Contract does not constitute a "cross-commodity" hedge. *See* February 10 Letter, Section V, p. 37.

Eligible Affiliate Definition

19. The Commission should eliminate its proposed definition of "eligible affiliate" in proposed CFTC Regulation 150.1 and instead adopt the definition of "eligible affiliate" contained in CFTC Regulation 50.52(a), which includes two subsidiaries of a common parent ("sister companies"). *See* February 10 Letter, Section XIV.A, p. 66-67.

Referenced Contracts

20. The Commission should publish a list of all Referenced Contracts traded on DCMs or SEFs. *See* February 10 Letter, Section XIV.B, p. 67-68.

150.2 SPECULATIVE POSITION LIMITS

Spot Month Speculative Position Limits (Section 150.2(a))

21. If spot month speculative limits are to be based on deliverable supply, the Commission should use current data. *See* February 10 Letter, Section X, p. 58-60.

22. Spot month speculative position limits should apply on an end-of-day basis. *See* July 13 Letter, Section II.C.5, p. 20.

Non-Spot Month Speculative Limits (Section 150.2(b))

23. Accountability levels are more appropriate than non-spot month speculative limits for energy markets. Further, they are more cost-effective than non-spot month limits for preventing excessive speculation. *See* March 30 Letter, Section III.A.3, p. 8-10; February 10 Letter, Section XI, p. 60-63.

24. The Commission should delegate to DCMs the authority to administer accountability levels applicable to energy market participants' non-spot month positions. *See* March 30 Letter, Section III.A.3, p. 8-10.

25. If non-spot month limits are adopted nonetheless, the proposed limits for NYMEX HO and RB futures contracts, among others, are too low. Based upon CFTC supplied data, the proposed limits would reduce market liquidity despite a lack of evidence that such liquidity constituted "excessive speculation." The Commission also must consider swap data before establishing non-spot month limits. *See* March 30 Letter, Section III.A.3, p. 8-10; February 10 Letter, Section XI, p. 60-63.

26. Any non-spot month speculative position limits, if adopted in a final rule must apply on an end-of-day basis. *See* July 13 Letter, Section II.C.5, p. 20.

150.5 EXCHANGE-SET SPECULATIVE POSITION LIMITS

27. The Exchanges should not be required to adopt the same process set forth under proposed CFTC Regulation 150.9 when administering exemptions from Exchange-set speculative position limits. *See* July 13 Letter, Section II.B.5, p. 14.

150.9 PROCESS FOR RECOGNITION OF POSITIONS AS NEBFHS

28. The Commission should eliminate the requirement in proposed CFTC Regulation 150.9(a)(1)(v), which requires Exchanges to have at least one year of experience in administering exchange-set positions limits for them to be permitted to process applications for NEBFHs. *See* July 13 Letter, Section II.B.3.b, p. 10.

29. The Commission should limit the information required in exemption applications submitted to the Exchange under proposed CFTC Regulations 150.9(a)(3)(iii)-(iv) to

information relating only to the specific Referenced Contract(s) and offsetting cash market positions for the previous year for which an exemption is sought. *See* July 13 Letter, Section II.B.3.c-d, p. 10-11.

30. The Commission should revise proposed CFTC Regulation 150.9(a)(6) and require the Exchanges to adopt rules as they deem appropriate that would establish the reporting requirements related to NEBFH applications. *See* July 13 Letter, Section II.B.3.e, p. 11-12.

31. The Commission should permit the Exchanges to recognize a NEBFH after an applicable federal speculative position limit has been exceeded by an applicant if the facts and circumstances warrant such action. *See* July 13 Letter, Section II.B.4, p. 13-14.

150.10 PROCESS FOR DCM/SEF EXEMPTION FOR CERTAIN SPREAD POSITIONS

32. The Working Group supports the utilization of the Exchanges to grant Spread Exemptions, but the Commission should ensure the Exchanges have full discretion and flexibility to grant Spread Exemptions by removing the Five-Day Rule from any provision under the BFH definition in proposed CFTC Regulation 150.1 and delegating the authority to the Exchanges to determine whether a physical-delivery Referenced Contract held in the spot month should receive an exemption from federal speculative position limits. *See* July 13 Letter, Sections II.A-B.2, p. 2-9.

33. The Commission should clarify that the term "spread position" set forth in proposed CFTC Regulation 150.3(a)(1)(iv) includes all types of spreads and the list of spreads referenced in proposed CFTC Regulation 150.10 is illustrative and not exhaustive. *See* July 13 Letter, Section II.B.3.a, p. 9-10.

34. The Commission should eliminate the requirement in proposed CFTC Regulation 150.10(a)(1)(ii), which requires Exchanges to have at least one year of experience in administering exchange-set positions limits for them to be permitted to process applications for Spread Exemptions. *See* July 13 Letter, Section II.B.3.b, p. 10.

35. The Commission should limit the information required in exemption applications submitted to the Exchange under proposed CFTC Regulation 150.10(a)(3)(iii) to information relating only to the specific Referenced Contract(s) and offsetting cash market positions for which an exemption is sought. *See* July 13 Letter, Section II.B.3.c, p. 10.

36. The Commission should revise proposed CFTC Regulation 150.10(a)(6) and require the Exchanges to adopt rules as they deem appropriate that would establish the reporting requirements related to Spread Exemption applications. *See* July 13 Letter, Section II.B.3.e, p. 11-12.

37. The Commission should permit the Exchanges to grant a Spread Exemption after an applicable federal speculative position limit has been exceeded by an applicant if the

facts and circumstances warrant such action. *See* July 13 Letter, Section II.B.4, p. 13-14.

150.11 Process for Recognition of Positions as Enumerated Anticipatory BFHs

38. The Working Group supports the utilization of the Exchanges to recognize Anticipatory BFHs, but the Commission should ensure the Exchanges have full discretion and flexibility to grant Anticipatory BFHs by removing the Five-Day Rule from any provision of the BFH definition in proposed CFTC Regulation 150.1 and delegating the authority to the Exchanges to determine whether a physical-delivery Referenced Contract held in the spot month should receive an exemption from federal speculative position limits. *See* July 13 Letter, Sections II.A-B.2, p. 2-9.

39. The Commission should eliminate the requirement in proposed CFTC Regulation 150.11(a)(1)(v), which requires Exchanges to have at least one year of experience in administering exchange-set positions limits for them to be permitted to process applications for Anticipatory BFHs. *See* July 13 Letter, Section II.B.3.b, p. 10.

40. The Commission should revise proposed CFTC Regulation 150.9(a)(6) and require the Exchanges to adopt rules as they deem appropriate that would establish the reporting requirements related to Anticipatory BFH applications. *See* July 13 Letter, Section II.B.3.e, p. 11-12.

41. The Commission should permit the Exchanges to recognize an Anticipatory BFH after an applicable federal speculative position limit has been exceeded by an applicant if the facts and circumstances warrant such action. *See* July 13 Letter, Section II.B.4, p. 13-14.

OTHER

Trade Options

42. The Commission should exempt trade options from federal speculative position limits and clarify that a derivatives position hedging a trade option is eligible to receive a BFH exemption. *See* July 13 Letter, Section II.C.3, p. 18-19; February 10 Letter, Section IX, p. 55-58.

Compliance Date

43. Market participants should be given at least nine months from the date that the Exchanges adopt Commission-approved rules implementing the Exemption process for purposes of complying with federal speculative spot month position limits and accountability levels. If the CFTC determines to adopt federal speculative non-spot month position limits, the Working Group recommends that the Commission establish a compliance date for such speculative limits at least twelve months from the date the Exchanges adopt Commission-approved rules implementing the Exemption process. *See* July 13 Letter, Section II.C.4, p. 19-20; February 10 Letter, Section XVI.A, p. 70.