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July 13, 2016

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

Re: Position Limits for Derivatives (RIN Number 3038-AD99)

Dear Mr. Kirkpatrick:

Nodal Exchange, LLC (Nodal Exchange or Exchange) appreciates the opportunity to submit comments with respect to the Commodity Futures Trading Commission's (CFTC or Commission) proposed rulemaking concerning *Position Limits for Derivatives: Certain Exemptions and Guidance*, 81 Fed. Reg. 38458 (June 13, 2016) (Proposed Rule). Nodal Exchange commends the Commission for the flexibility provided in the Proposed Rule for commercial hedgers to accommodate hedging more effectively.

Nodal Exchange is a registered designated contract market operating as such since September 30, 2013 that serves the electricity markets by offering cash settled futures contracts on power in North America. All Nodal Exchange contracts (Nodal Contracts) are for monthly terms and are central counterparty cleared by Nodal Clear. Nodal Exchange also offers natural gas contracts for the benefit of being able to cross-margin power and natural gas open positions. The electric power markets are not like typical commodity markets because electricity cannot be stored economically. Since variations in supply, demand and transmission constraints lead to price variances by location, it is important to be able to hedge with contracts for the price of power at specific locations, leading to a very high number of required contracts.

Nodal Exchange has become a vital market distinguished by its granularity and is the only cleared market for over 506 locations at the hubs, zones, and generation nodes in the United States. The Exchange enables market participants to hedge their risks through locational spread trades that provide liquidity for locations with less trading activity without the price risk inherent in outright positions. Spread trading on the Exchange enables market participants to hedge their risks at multiple locations and enhances liquidity for *bona fide* hedgers. For the period from July 2015 through June 2016, intramarket spread trades accounted for 96% of total volumes traded on the Exchange. The Exchange submits these comments concerning the Proposed Rule and its impact on the Exchange's market.

I. Differentiation Between Intramarket and Intermarket Spread Exemption Application Procedures is Recommended to Enhance Liquidity and Reduce Administrative Costs while still Meeting Objectives of the CEA

The Proposed Rule establishes the same prescriptive application procedures for both intermarket and intramarket spread exemptions alike although, from the exchange's perspective, these trades are very different. As explained in the Proposed Rule, intermarket spreads are created between contracts on different exchanges.[1] Each exchange that is party to the intermarket spread would be expected to rely on information provided by the market participant regarding the contracts on the other exchange. The application procedures in the Proposed Rule are intended to provide sufficient information for the exchange to determine whether to grant a spread exemption. However, intramarket spreads occur on the same exchange[2] where the exchange itself is likely the source of accurate and timely information regarding the contracts in the spread transaction. For Nodal Exchange, its ability to assess intramarket spreads efficiently provides liquidity to its *bona fide* hedgers.

The Proposed Rule discusses the role of spreads in enhancing liquidity in commodity markets with less trading activity and recognizes the use of different types of spreads, such as calendar spreads; quality differential spreads; processing spreads; and product or by-product differential spreads. The spread exemption application procedures in the Proposed Rule requires the market applicant provide detailed information to demonstrate that the spread exemption would further the purposes of CEA section 4a(a)(3)(B),[3] which establishes the objectives of (i) diminishing, eliminating, or preventing excessive speculation; (ii) deterring and preventing market manipulation, squeezes, and corners; (iii) ensuring sufficient market liquidity for *bona fide* hedgers; and (iv) ensuring that the price discovery function of the underlying market is not disrupted. The Proposed Rule is overly prescriptive as to the information that must be provided by the applicant, especially when the exchange may have superior information regarding intramarket spreads. Unlike intermarket spreads, the exchange, and not the applicant, is more likely to have direct information to determine whether an intramarket spread achieves the goals of CEA 4a(a)(3)(B). For example, Nodal Exchange has current deliverable supply analysis, spread and outright trading activity information, and market data from spot markets for the underlying physical commodities. In performing its pricing and surveillance functions, Nodal Exchange monitors position accumulation information that is not available to market participants as well as out-of-market pricing in real time.

In order to process an intramarket spread exemption application, the exchange is uniquely positioned to assess liquidity for *bona fide* hedgers and the price discovery function. For intramarket spreads, the exchange has real time market information that would likely displace information provided by the applicant, and would render the process of obtaining such information from the applicant as useless to the exchange. The prescribed procedures for intramarket spread exemption applications could become inefficient and time consuming thereby hindering the exchange from effectively supporting its *bona fide* hedgers. For example, the

[1] Proposed Rule 150.1 Definitions.

[2] *Ibid.*

[3] Proposed Rule 150.10(a)(3)(i).

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Proposed Rule requires the market participant to apply sufficiently in advance to permit the exchange to make a determination *before* the date of the transaction.[4] Such timeliness requirements may be unnecessary for the exchange that is processing intramarket spread exemption applications, especially in certain markets where the market data may become outdated within a couple of days.

Nodal Exchange respectfully recommends that for any intramarket spread, the Commission provide the exchange with the flexibility and discretion to establish its application process, including the information it needs from applicants in order to determine whether exempting the spread trade achieves the policy objectives of CEA 4a(a)(3)(B), for which the Commission has the authority to review the exchange's rules and conclusions. The exchange's oversight of its markets and its specialized skills with regards to such markets enables the exchange to best determine the type of information it requires of its applicants in order to determine whether the granting of an intramarket spread exemption will further the purposes of CEA section 4a(a)(3)(B). The Commission's rules should be sufficiently flexible to enable exchanges to use the most accurate and current information to determine whether intramarket spread exemptions should be granted.

II. RFC 20. Are there concerns regarding the applicability of spread exemptions in the spot month that the Commission should consider? Should the Commission, parallel to the requirements of current § 1.3(z)(2), provide that such spread positions not be exempted during the lesser of the last five days of trading or the time period for the spot month?

Nodal Exchange has no concerns regarding the applicability of spread exemptions in the spot month for our markets. On the contrary, the Exchange would support the applicability of the spread exemption through the end of the month, without limiting the exemption during the current month. Nodal Exchange futures contracts on electricity settle to the independent, spot market overseen by the ISO/RTO markets. Since the settlement prices are determined in the ISO/RTO markets, trading during the last five days of the spot month has no impact on final settlement prices on either Nodal Exchange or the ISO/RTO spot markets. In fact, *bona fide* hedgers rely on the ability to hold positions through the end of the current month, which has very low volume traded for monthly power contracts. Restrictions on spread exemption during the last five days of trading may force market participants to exit their position during a period of lower liquidity – more than 99% of trading volume occurs outside the current (spot) month on Nodal Exchange.

[4] Proposed Rule 150.10(a)(4)(i).

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III. RFC 53. Does permitting the exchanges to administer application processes for NEBFHs, spread exemptions, and enumerated anticipatory bona fide hedgers further the goals of CEA section 4a(a)(3)(B) and properly protect market participants and the public?

As discussed above, the exchanges are often privy to the most accurate and current market data necessary to determine whether exemptions further the goals of CEA section 4a(a)(3)(B) because the exchanges are monitoring trading activity and market data for the underlying commodities. The exchanges' access to such information enables effective review of exemption applications, which properly protects market participants and the public. Nodal Exchange possesses the specialized skills to effectively assess liquidity for *bona fide* hedgers and the price discovery function in order to make the appropriate conclusions for granting exemptions.

IV. RFC 59. Are there any anti-competitive effects between exchanges, or exchanges and SEFs, because the rule proposed in this supplemental proposal have the practical effect of allowing exchanges to recognize and grant exemptions from position limits? If so, what are they? Please explain.

Allowing exchanges to recognize and grant exemptions from position limits does not have anti-competitive effects between exchanges. Indeed, current rules permit exchanges to grant exemptions. However, Nodal Exchange is concerned that the overly prescriptive intramarket spread exemption application process in the Proposed Rule will diminish spread trading on all exchanges, potentially driving such transactions off-exchange. Since the Exchange market is 96% spread trading volume, this will have an anti-competitive impact on Nodal Exchange as other exchanges are much less exposed to decreases in spread trading. Existing spread exemption application procedures referenced by the Commission in the Proposed Rule may have been implemented at exchanges where spread trading is relatively minimal compared to outright trading volumes. Nodal Exchange's market growth is largely attributed to spread trading that has provided liquidity in less active markets providing *bona fide* hedgers with more accurate tools for managing their risks.

Aside from the spread exemption application process, the requirement in Proposed Rule § 150.10(a)(7) would also have an anti-competitive effect on markets like Nodal Exchange that rely on intramarket spread trading to enhance liquidity on less actively traded contracts. Proposed Rule § 150.10(a)(7) requires the exchange to publish on its website, on at least a quarterly basis, a summary describing the types of exempted spread trades explaining why they were exempted. The information that would be published by Nodal Exchange would provide details of all components of spread trading within its specialized market. Since the number of market participants engaged in specialized markets tend to be few, competitors are more able to derive identifying information from the published details required by the Proposed Rule.

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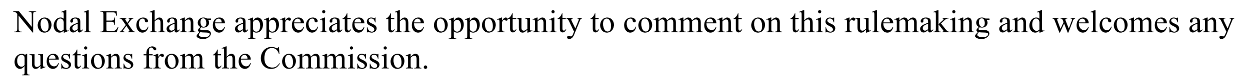

Nodal Exchange appreciates the opportunity to comment on this rulemaking and welcomes any questions from the Commission.

Sincerely,

/s/ Anita Herrera
General Counsel & Chief Regulatory Officer

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