EVERSHEDS SUTHERLAND

February 28, 2017

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

VIA ELECTRONIC SUBMISSION

Re: Reproposal, Position Limits for Derivatives, RIN 3038-AD99

Dear Secretary Kirkpatrick:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group ("**Working Group**") and the Commodity Markets Council ("**CMC**") (collectively, the "**Commercial Alliance**"), Eversheds Sutherland (US) LLP hereby submits this comment letter in response to the request for public comment set forth in the Commodity Futures Trading Commission's (the "**CFTC**" or "**Commission**") Reproposal, *Position Limits for Derivatives* ("**Reproposal**"),[1] which proposes to establish pursuant to Commodity Exchange Act ("**CEA**") Section 4a(a),[2] as amended by Section 737 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**"), new federal speculative position limits for certain physical commodity derivative transactions.[3]

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 regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and

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1 *See Position Limits for Derivatives*, Reproposal, 81 Fed. Reg. 96,704 (Dec. 30, 2016).

2 7 U.S.C. § 6a(a).

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

other contracts that reference energy commodities.

CMC is a trade association that brings together exchanges and their industry counterparts. Its members include commercial end-users that utilize the futures and swaps markets for agriculture, energy, metal, and soft commodities. Its industry member firms also include regular users and members of swap execution facilities (each, a "**SEF**") as well as designated contract markets (each, a "**DCM**," and together with SEFs, the "**Exchanges**"), such as the Chicago Board of Trade ("**CBOT**"), Chicago Mercantile Exchange, ICE Futures US ("**IFUS**"), Minneapolis Grain Exchange ("**MGEX**"), NASDAQ Futures, Inc. ("**NFX**"), and the New York Mercantile Exchange ("**NYMEX**"). Along with these market participants, CMC members also include regulated derivatives exchanges. The businesses of all CMC members depend upon the efficient and competitive functioning of the risk management products traded on the Exchanges and over-the-counter ("**OTC**") markets.

The Commercial Alliance requests that the Commission consider the comments provided herein along with comments previously submitted by the Working Group[4] and CMC[5] in this rulemaking proceeding.

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[4] *See* The Commercial Energy Working Group, *Comment Letter Re: Supplemental Notice of Proposed Rulemaking, Position Limits for Derivatives: Certain Exemptions and Guidance*, RIN 3038-AD99 (July 13, 2016) ("**July 13th Letter**"); The Commercial Energy Working Group, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (Mar. 30, 2015) ("**March 30th Letter**"); The Commercial Energy Working Group, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (Aug. 4, 2014) ("**August 4th Letter**"); The Commercial Energy Working Group, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (Feb. 10, 2014) ("**February 10th Letter**") (collectively, the "**Comment Letters**"); The Commercial Energy Working Group, *Request for Exemptive Relief No. 7 for Working Session on BFH Petition* (submitted to S. Sherrod, Senior Economist, Division of Market Oversight, on Sept. 19, 2012) ("**Revised Request for Exemptive Relief No. 7**"); Working Group of Commercial Energy Firms, *Petition for Commission Order Granting Exemptive Relief for Certain Bona Fide Hedging Transactions under Section 4a(a)(7) of the Commodity Exchange Act* (Jan. 20, 2012) ("**BFH Petition**") (In February 2012, the Working Group of Commercial Energy Firms reconstituted itself as "The Commercial Energy Working Group"), http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgbfhpetition012012.pdf; *see also* The Commercial Energy Working Group presentations and comments provided at the CFTC's July 29, 2015 Energy and Environmental Markets Advisory Committee ("**EEMAC**") Meeting, https://www.youtube.com/watch?v=xpE-sthXOws&feature=youtu.be; February 26, 2015 EEMAC Meeting ("**2015 EEMAC Meeting**"), https://www.youtube.com/watch?v=yGLWQsuqZ-w&feature=youtu.be; and June 19, 2014 Position Limits Roundtable ("**2014 Roundtable**"), https://www.youtube.com/watch?v=jx5ZryxlRsI&feature=youtu.be; https://www.youtube.com/watch?v=pbKC8GJeQGU&feature=youtu.be.

[5] CMC, *Comment Letter Re: Supplemental Notice of Proposed Rulemaking, Position Limits for Derivatives: Certain Exemptions and Guidance*, RIN 3038-AD99 (July 13, 2016); CMC, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (Mar. 28, 2015); CMC, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (July 25, 2014); CMC, *Comment Letter Re: Position Limits for Derivatives*, RIN 3038-AD99 (Feb. 10, 2014); CMC, *Letter Re: Position Limits Rule – Anticipatory Hedging* (Sept. 24, 2013).

II. EXECUTIVE SUMMARY.

The Commercial Alliance has been an active participant in the Commission's speculative position limits rulemaking. As further discussed below in Section III.B, the Commercial Alliance appreciates the efforts of the Commission to make several improvements in the Reproposal to promote effective commercial hedging activity consistent with the statutory objectives of CEA Section 4a(a). However, notwithstanding the improvements, other aspects of the Reproposal likely would have adverse impacts on a commercial firm's ability to effectively hedge its exposures to risk. The Commercial Alliance thus offers the following comments and recommendations to help the Commission ensure that it does not adopt new speculative position limit rules that unnecessarily harm commercial hedgers.

Necessity Finding. As an initial matter, and as discussed below in Section III.A.1, the Commercial Alliance does not believe the Commission should adopt any new federal speculative position limits in any physical commodity derivatives market until it has defined "excessive speculation" and found that speculative position limits are necessary to protect against excessive speculation in each physical commodity derivatives market in which the Commission proposes to establish speculative limits. The Commission should make a separating finding that new federal speculative limits are necessary to prevent excessive speculation in the spot months and non-spot months of each physical commodity market before it adopt any such limits.

Cost-Benefit Analysis. The Commission should engage in a thorough cost-benefit analysis before it adopts any new requirements or rules in this proceeding. As noted in Section III.A.2, the Reproposal's new federal speculative position limits framework, including the "bona fide hedging position" ("**BFH**") definition, if adopted as proposed, would impair the ability of commercial firms in physical commodity markets to effectively hedge their risk exposures. The Commercial Alliance submits that the cost-benefit analyses provided in the Reproposal grossly underestimate certain costs that would be imposed upon commercial hedgers.

Legacy Agricultural Contracts. While the Commercial Alliance believes the Commission should make a necessity finding for each new speculative position limit it wishes to establish and engage in a thorough cost-benefit analysis before adopting any new speculative position limits and related regulatory requirements, the CFTC should promptly modify its existing BFH definition under CFTC regulation 1.3(z), which currently applies to market participants trading legacy agricultural contracts,[6] to align with present-day commercial hedging practices. As described below in Section III.A.3, the Commercial Alliance requests that the Commission prior to, or simultaneously with, its consideration of

[6] "Legacy agricultural contracts" include those contracts currently subject to federal speculative position limits under existing Part 150 of the CFTC's regulations: CBOT Corn (and Mini-Corn), Oats, Soybeans (and Mini-Soybeans), Wheat (and Mini-Wheat), Soybean Oil, Soybean Meal, MGEX Hard Red Spring Wheat ("**MWE**"), IFUS Cotton No. 2 ("**CT**"), and CBOT KC HRW Wheat ("**KW**").

adopting new federal speculative limits, revise the BFH definition under CFTC regulation 1.3(z) to (i) include enumerated BFH exemptions for certain risk-reducing practices that are commonly utilized in legacy agricultural markets, including hedges of merchandising and anticipated merchandising activity, (ii) eliminate the Five-Day Rule,[7] and (iii) provide the Exchanges flexibility in granting exemptions from federal speculative position limits for non-enumerated BFHs ("**NEBFH**s"), certain enumerated anticipatory BFHs, and spread positions ("**Exchange Exemption Process**").

Four Key Revisions. If the Commission determines it is necessary and appropriate to adopt a final rule establishing new federal speculative limits, four aspects of the Reproposal, which are further described below in Section III.C, should be modified to avoid causing substantial harm to commercial firms:

1. ***Economically Appropriate Test.***[8] The Reproposal's new interpretation of the Economically Appropriate Test should be withdrawn for the reasons described below in Section III.C.1.

2. ***Enumerated BFHs.*** As described below in Section III.C.2, the list of enumerated BFHs should be (i) expanded to include certain risk-reducing practices commonly utilized in energy and agricultural markets, including hedges of merchandising and anticipated merchandising activity; and (ii) eliminate the Five-Day Rule.

3. ***Accountability Levels.*** Accountability levels should be adopted instead of new federal non-spot month speculative position limits given the reasons described below in Section III.C.3. The Exchanges should be permitted, as they currently do today, to administer and monitor compliance with the accountability levels.

4. ***Reporting Requirements.*** As further discussed below in Section III.C.4, the reporting requirements associated with BFH exemptions and Form 204 should be more narrowly tailored to require the reporting of only the cash positions considered by a bona fide hedger in the normal course of its business in calculating its hedging needs.

Exchange Exemption Process. The Exchanges should be permitted based on facts and circumstances to provide retroactive exemptions from federal speculative position limits for NEBFHs, enumerated anticipatory BFHs, and spread positions. As described

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[7] The "Five-Day Rule" refers to the restriction found in the proposed BFH definition on holding physically-delivered Referenced Contracts during the lesser of the last five days of trading or the time period for the spot month in such physically-delivered Referenced Contract.

[8] The "economically appropriate test" refers to the requirement set forth in the proposed BFH definition under proposed CFTC regulation 150.1, which states that a BFH, among other things, must be "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise" ("**Economically Appropriate Test**"). *See* proposed CFTC regulation 150.1.

below in Section III.D.1, this and other modifications to the Exchange Exemption Process, such as the Exchange reporting requirements, should be adopted.

Referenced Contracts. The Commission should publish an exhaustive list of Exchange-listed Referenced Contracts and update the location basis contract list in Appendix B to Part 150 of the CFTC's regulations. The Commission should permit the Exchanges to help update such lists as described below in Section III.D.2.

Pass-Through Swaps and Offsets. As further described below in Section III.D.3, in an affiliated group, affiliate members should be permitted to utilize exemptions for pass-through swaps and offsets.

Compliance Date. As recommended below in Section III.E, the Commission should adopt a phased-in compliance schedule for any new speculative position limits established in this proceeding wherein market participants would be given (i) at least nine months from the date that the Exchanges adopt Commission-approved rules implementing the Exchange Exemption Process to come into compliance with spot month speculative position limits and (ii) at least twelve months from the date the Exchanges adopt Commission-approved rules implementing the Exchange Exemption Process to come into compliance with non-spot month speculative limits.

III. COMMENTS.

A. Before the Commission Finalizes Any New Federal Speculative Position Limits Rule, the Commission Should Undertake Three Important Steps.

1. The Commission Should Reconsider Whether Any New Speculative Position Limits Are Necessary Before Adopting Them.

In contrast to the Commission's views set forth in the Reproposal, CEA Section 4a(a) does ***not*** mandate or permit the Commission to adopt without proper foundation any new, prophylactic federal speculative position limits for physical commodity derivatives contracts. Rather, CEA Section 4a(a)(1) requires the Commission to determine on a commodity-specific basis whether any new federal speculative limits are necessary to prevent an undue or unnecessary burden on interstate commerce caused by excessive speculation. Specifically, CEA Section 4a(a)(1) states:

> ***Excessive speculation*** in ***any commodity*** under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets or derivatives transaction execution facilities, or swaps that perform or affect a significant price discovery function with respect to registered entities ***causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity***, ***is an undue and unnecessary burden on interstate commerce*** in such commodity. For the purpose of diminishing, eliminating, or preventing such burden, the

> Commission shall, from time to time, after due notice and opportunity for hearing, by rule, regulation, or order, proclaim and fix such limits on the amounts of trading which may be done or positions which may be held by any person . . . ***as the Commission finds are necessary to diminish, eliminate, or prevent such burden***.[9]

As large commercial users of physical commodity derivatives markets, Commercial Alliance members support the goals of Title VII of the Dodd-Frank Act to maintain the integrity of such markets and protect the commercial hedging activity of the Commercial Alliance members. In this vein, the Commercial Alliance does not oppose an adequately justified and appropriately tailored framework implementing new federal speculative positions limits that protect the physical commodity derivatives markets against excessive speculation. However, consistent with the express language of CEA Section 4a(a)(1), the Commission should impose new federal speculative position limits only after making a finding that they are necessary to diminish, eliminate, or prevent excessive speculation in a specific commodity market.

Given the Reproposal fails to define "excessive speculation" and demonstrate that federal speculative position limits are necessary to prevent excessive speculation in each commodity derivatives market the Commission proposes to establish such speculative limits, there is no justification supporting the adoption of new federal speculative position limits. Accordingly, the Commercial Alliance requests that the Commission impose new federal speculative limits only after defining "excessive speculation" and making a distinct finding that they are necessary to prevent excessive speculation in each physical commodity derivatives market the Commission seeks to impose such limits. Because the market dynamics are different in the spot and non-spot months, the Commission should make a separate finding that new speculative position limits in the spot and not-spot month of each physical commodity market are necessary to prevent excessive speculation.

2. <u>The Commission Should Engage in a Thorough Cost-Benefit Analysis Before Adopting Any Specific Requirements or Rules Implementing a New Speculative Position Limits Framework</u>.

As further described herein, the Reproposal's federal speculative position limits framework, including its BFH definition, if adopted as proposed, will cause significant harm to commercial hedging practices, disrupt liquidity in physical commodity markets, and prevent price convergence in physical commodity markets. Additionally, certain of the Reproposal's reporting requirements are commercially impractical and do not align with the regular business practice of many commercial firms. If such reporting requirements are implemented, they will impose substantial costs upon market participants.

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[9] CEA Sections 4a(a)(2)-(3) also state that the Commission should establish position limits "as appropriate."

The Commercial Alliance submits that the Commission's cost-benefit analysis grossly understates the costs market participants will bear under the Reproposal. For example, the Reproposal estimates the total annual cost to market participants submitting a Form 204 would be $4,392. This estimate appears to assume that a market participant will need 3 hours to complete one Form 204. However, the Commercial Alliance submits that, if Form 204 is adopted as proposed, it could take substantially longer for a market participant to collect data on all its cash positions, especially if the market participant is a global company with several affiliates located in the U.S. and abroad trading multiple commodities. Moreover, the Commercial Alliance submits that all commercial hedgers would incur significant initial costs to implement new IT systems and business processes to comply with the newly proposed Economically Appropriate Test and proposed Form 204 reporting requirements.

Accordingly, the Commercial Alliance recommends that the Commission reconsider the cost-benefit analysis set forth in the Reproposal and subject all aspects of the Reproposal to a new, thorough cost-benefit analysis before any final regulations or guidance are adopted in this proceeding.

3. The Commission Should Promptly Revise its Existing BFH Definition that Currently Applies to Commercial Firms Trading Legacy Agricultural Contracts.

The Commercial Alliance believes the Commission should make a necessity finding and engage in a thorough cost-benefit analysis before adopting any new speculative position limits. However, the CFTC's existing federal speculative position limits framework, specifically, the BFH definition under CFTC regulation 1.3(z), is outdated and does not align with present-day commercial hedging practices in legacy agricultural markets that are currently subject to the CFTC's speculative position limits. Accordingly, as further described below in Sections III.C.2 and III.D.1, the CFTC should promptly modify its existing BFH definition under CFTC regulation 1.3(z) to: (i) expand the list of enumerated BFH exemptions to include risk-reducing practices commonly used in legacy agricultural markets that are not enumerated in CFTC regulation 1.3(z) (*e.g.*, hedges of merchandising and anticipated merchandising activity); (ii) eliminate the Five-Day Rule from any enumerated BFH; and (iii) provide Exchanges the authority and flexibility to grant NEBFH, certain enumerated anticipatory BFH, and spread exemptions pursuant to the Exchange Exemption Process. The Commercial Alliance submits that the CFTC may undertake these revisions to the BFH definition under existing CFTC regulation 1.3(z) before, or simultaneously with, its consideration of adopting new federal speculative position limits.

CMC COMMODITY MARKETS COUNCIL

B. The Commercial Alliance Appreciates the Progress Made Under the Reproposal in Establishing a More Workable Framework for Commercial Hedgers.

The Commercial Alliance appreciates the Commission's efforts to adopt a regulatory framework that incorporates several recommendations offered by the Commercial Alliance that would permit effective commercial hedging activity while protecting physical commodity markets against excessive speculation should it exist. Specifically, the Commercial Alliance supports the following progress made in the Reproposal:[10]

- Recognizing more appropriate updated deliverable supply estimates for purposes of establishing spot month speculative limits.
- Withdrawing the quantitative test as proposed in the December 2013 Proposal.[11]
- Eliminating from the BFH definition the incidental test and orderly trading requirement.[12]
- Providing authority to the Exchanges to administer exemptions for NEBFHs, enumerated anticipatory BFHs, and spread positions.
    - While the Commercial Alliance submits the following positions should be enumerated BFHs, the Commercial Alliance appreciates the Reproposal's proposal to:

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[10] The Commercial Alliance appreciates the Commission's preamble guidance stating that, under the Reproposal, sister companies would not be required to comply separately with speculative position limits under CFTC regulation 150.2(c)(2) if such entities met the "eligible affiliate" definition. *See* Reproposal at 96,731. However, the Reproposal failed to modify the regulatory text of the "eligible affiliate" definition under proposed CFTC regulation 150.1 to include sister affiliates in accordance with this preamble guidance. Accordingly, to provide more clarity and certainty, the Commercial Alliance requests that the Commission modify the regulatory text of the "eligible affiliate" definition under proposed CFTC regulation 150.1 to reflect the definition of "eligible affiliate" set forth in existing CFTC regulation 50.52(a), which expressly includes two subsidiaries of a common parent (*i.e.*, sister affiliates).

[11] *See Position Limits for Derivatives*, Notice of Proposed Rulemaking, 78 Fed. Reg. 75,680, at 75,717 (Dec. 12, 2013) (the "**December 2013 Proposa**l") (proposing a safe harbor for a cross-commodity hedge exemption if the correlation between the daily spot price series for the target commodity and the price series for the commodity underlying the derivatives contract used for hedging is at least .80 for a time period of at least thirty-six months).

[12] To qualify for a BFH exemption, the December 2013 Proposal's "incidental test" required that the purpose of a derivatives contract be to offset price risks incidental to commercial cash, spot, or forward operations, and the "orderly trading requirement" required a derivatives position to be established and liquidated in an orderly manner in accordance with sound commercial practices. *See* Reproposal at 96,743.

- withdraw prior Commission statements in the 2016 Supplemental Proposal[13] that certain types of merchandising and anticipated merchandising activity did not meet the Economically Appropriate Test (*i.e.*, binding, irrevocable bids or offers and hedges of unfilled storage capacity); and

- permit the Exchanges to (i) grant waiver of the Five-Day Rule in exemptions for NEBFHs, enumerated anticipatory BFHs, and spread positions; and (ii) recognize NEBFH for merchandising and anticipated merchandising activity.

- Reducing the requirements placed upon the Exchanges under proposed CFTC regulations 150.9-11 to administer exemptions for NEBFHs, enumerated anticipatory BFHs, and spread positions.

- Providing the Exchanges more flexibility in developing the application and reporting requirements placed upon market participants seeking exemptions under the Exchange Exemption Process.

- Confirming the Exchange Exemption Process applicable to exemptions from federal speculative position limits need not apply to the manner in which Exchanges provide exemptions from Exchange-set limits.

- Delaying compliance for an Exchange to establish speculative position limits on swaps until the Exchange has access to adequate swap data.

- Including a BFH exemption for offsets of BFH swap positions.

- Excluding trade options from the Referenced Contract definition.

- Providing BFH treatment for Referenced Contracts that hedge trade options.

C. If the Commission Determines it Necessary and Appropriate to Proceed with a Final Rule Establishing New Speculative Position Limits, the Commission Should Adopt Four Major Modifications to the Reproposal to Avoid Harm to Commercial Hedging Activity.

Notwithstanding the Reproposal's progress in developing a workable framework for implementing new federal speculative position limits, the following three major

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

modifications to the Reproposal are needed to reflect Congress's long-standing intent to preserve legitimate commercial hedging activity:

- Withdrawal of the newly proposed interpretation of the Economically Appropriate Test.

- Modification to the list of enumerated BFHs to (i) include certain risk-reducing practices commonly used in energy and agricultural markets, such as hedges of merchandising and anticipated merchandising activity, and (ii) eliminate the Five-Day Rule.

- Implementation of accountability levels instead of new non-spot month speculative position limits.

- Adoption of more narrowly tailored reporting requirements associated with BFH exemptions.

1. The New Interpretation of the Economically Appropriate Test Should Be Eliminated.

i. *The New Interpretation of the Economically Appropriate Test is Unworkable for Commercial Hedgers.*

The Reproposal's BFH definition under proposed CFTC regulation 150.1 requires a BFH to be, among other things, "economically appropriate to the reduction of risk in the conduct and management of a commercial enterprise."[14] While this proposed definition reflects the plain language of the statutory BFH definition,[15] the Reproposal suggests that the CFTC's interpretation of the Economically Appropriate Test will be as set forth in the December 2013 Proposal. Under the December 2013 Proposal, the CFTC's interpretation of the Economically Appropriate Test, for the first time in the Commission's history, would require a company to consider at the level of the aggregated enterprise rather than at the level an individual company deems appropriate (*e.g.*, at the legal entity, desk, book, asset, or any other level) ***all*** of its exposures in determining whether a derivative position "reduces the risk . . . of a commercial enterprise."[16] For example, the Reproposal states that it would not be economically appropriate to the reduction of risk for a processor to offset the price risk of either its unfilled anticipated requirement for the input commodity or its unsold anticipated production, and that to be economically appropriate to the reduction of

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[14] *See* proposed CFTC regulation 150.1 (providing BFH definition).

[15] *See* CEA Section 4a(c)(2)(A)(ii).

[16] *See* Reproposal at 96,746; *see also* December 2013 Proposal at 75,709 (stating that "[i]n order for a position to be economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, the enterprise generally should take into account ***all*** **inventory or products that the enterprise owns or controls, or has contracted for purchase or sale at a fixed price**") (emphasis added).

risk, the processor must offset both its inputs and outputs associated with its processing operation.[17] In this regard, the Reproposal proposes to substitute (a) the discretion of individual commercial firms to manage their risks in accordance with their business objectives and judgment for (b) a predetermined, government-mandated one-size-fits-all risk management framework.

Importantly, while the Economically Appropriate Test has been a part of the statutory and regulatory speculative position limits framework for decades, this proposed interpretation is new and represents an overly simplistic view of risk management that departs from the way in which commercial firms historically have managed their risk exposures.[18] The commercial infeasibility of the newly proposed interpretation of the Economically Appropriate Test has been thoroughly discussed at the CFTC's 2014 Roundtable,[19] 2015 EEMAC meeting,[20] and in the Comment Letters.[21] The following examples also illustrate how unworkable the proposed interpretation of the Economically Appropriate Test would be on commercial hedgers if they must consider all inventory and

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17 *See* Reproposal at 96,748.

18 The Commercial Alliance submits that the Commission has not identified, nor can the Commercial Alliance find, in historical rulemakings, orders, or guidance, any CFTC precedent that requires a commercial firm to net down its entire enterprise-wide physical exposure for purposes of determining whether it can receive BFH treatment.

19 *See Position Limits for Derivatives and Aggregation of Positions*, Notice of Proposed Rulemaking; Reopening of Comment Periods, 79 Fed. Reg. 30,762 (May 29, 2014) (establishing the CFTC's 2014 Roundtable); *see also* Position Limits Roundtable Transcript, at p. 15-16, 30-34, 47-49 (Panelists from the Commercial Alliance noting that (i) the Commission's newly proposed interpretation of the Economically Appropriate Test is not feasible given the multiplicity of risks participants transacting in present-day commodity markets must consider, and (ii) addressing risk on a holistic, enterprise-wide basis is commercially impracticable and inconsistent with the regular business practices of market participants in energy and agricultural markets); 54-56 (comments of Professor John Parson discussing the reasons why the Commission's newly proposed interpretation of the Economically Appropriate Test is neither practicable nor commonly utilized by commercial hedgers), http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission_061914-trans.pdf.

20 *See Position Limits for Derivatives and Aggregation of Positions*, Notice of Proposed Rulemaking; Provision of Table 11a; and Reopening of Comment Periods, 80 Fed. Reg. 10,022 (Feb. 25, 2015) (establishing the CFTC's 2015 EEMAC Meeting); *see also* 2015 EEMAC Meeting Transcript, at Panel III, p. 158-70, 186-91, 216-18 (EEMAC participants from the Commercial Alliance and Southern Company stating the Commission's newly proposed "one-size-fits-all" approach for interpreting and applying the Economically Appropriate Test is neither commercially nor operationally practicable for the management of risks presented by complex and diverse physical commodity portfolios); 196-200 (EEMAC participant from the National Rural Electric Cooperative Association stating that Congress did not intend for the CFTC to substitute its judgment for the business judgment of commercial end-users who are trying to hedge their commercial risk in connection with their "business of providing modern civilization"), http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/emactranscript022615.pdf.

21 *See* July 13th Letter, Section II.C.1, at 15-17; March 30th Letter, Section III.C.2, at 11-14; August 4th Letter, Section III.A, at 6-8; February 10th Letter, Section III.A, at 11-14.

contracts of the commercial enterprise in determining their BFH needs.[22]

> *Example 1 – Location – Entity A has natural gas in inventory at the Chicago Citygate and a fixed price sale to supply natural gas in Los Angeles. Its regular business practice is to manage those risks independently because the Chicago natural gas market is subject to different supply and demand fundamentals than the Los Angeles natural gas market. It is unrealistic to expect Entity A to manage the Los Angeles and Chicago risks collectively. Because the Chicago and Los Angeles markets are geographically dislocated, Entity A could not use the natural gas inventory in Chicago to satisfy the obligation of its separately negotiated sale of natural gas in Los Angeles. Yet the proposed Economically Appropriate Test would effectively require Entity A to hedge both or neither. Entity A would not receive BFH treatment under the Reproposal if it treated these outlined risks as separate price risk profiles.*
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> *Example 2 – Location – Entity A has fixed price contracts to sell corn to local ethanol plants and local feed mills located in Iowa. Entity A also owns a grain elevator with corn inventory in Egypt where it distributes grains to local merchants or mills. Its regular business practice is to manage those risks independently because the distribution price for corn in Egypt is subject to different supply and demand fundamentals than the Iowa corn market. Because the Iowa and Egypt markets are geographically dislocated, Entity A could not use the corn inventory in Egypt to satisfy its obligation of its separately negotiated sales of corn in Iowa. Yet the proposed Economically Appropriate Test would require Entity A to hedge the risks for both or neither of these elevators. Entity A would not receive BFH treatment under the Reproposal if it treated these outlined risks as separate price risk profiles in accordance with its prudent risk management practices.*
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> *Example 3 – Timeframe – Entity A has a fixed price contract to sell 300,000 barrels of M1 grade gasoline to a gasoline wholesale distributor in each Colonial Pipeline Cycle that will ship gasoline from the U.S. Gulf Coast starting in October 2017 (approximately 1,500,000 bbls). As of February 15, 2017, Entity A also has a current inventory of 1,000,000 barrels of M1 grade gasoline at a storage terminal in the U.S. Gulf Coast. Entity A's regular business practice is to manage the associated operational and financial exposures of the February 17 inventory and October 17 fixed price sale transaction independently because the supply and demand fundamentals for M1 grade gasoline in February 2017 will*

[22] These examples generally are taken from the March 30th Letter. *See* March 30th Letter, Section III.C.2, at 11-14.

be different from those of M1 grade gasoline in October 2017. Yet the proposed Economically Appropriate Test would require Entity A to hedge both the purchase and the sale or hedge neither. Entity A would not receive BFH treatment under the Reproposal if it treated these outlined risks as separate price risk profiles.

*Example 4 – Different Business Lines – Entity A is an integrated oil company. Its exploration and production ("**E&P**") businesses are managed independently of its refineries. The E&P business naturally is long crude oil, and the refinery has sold some of its excess inventory. The price of crude oil has been in steep decline, and the forecast for the general economy is weak. The Reproposal would not provide a BFH exemption if the E&P business entered a short futures position to hedge the risk of a further price decline and the refinery did not put on a long position to hedge its fixed price sale, even though that hedge will cause the refinery to lose money if the market continues to decline. In this example, the Commission would disadvantage integrated oil companies whose shareholders prefer that upstream oil production be exposed to crude oil market prices and not be hedged. As a result of the application of an unduly rigorous interpretation of the Economically Appropriate Test, the downstream affiliates of integrated oil companies that do not hedge their upstream crude oil production would not be allowed to hedge their crude oil supply requirements if their upstream affiliates chose not to hedge their production. This would negatively impact the refining margins of downstream affiliates and ultimately increase the financial risks associated with those operations.*

Example 5 – Management of Physical Assets – Entity A has five different power plants, and its regular business practice is to manage each independently. Three plants are net long natural gas, and the other two plants are net short. The decisions to hedge a particular plant also may be driven by seasonality, location and access to natural gas via different pipelines, load, other supply and demand factors, and different regulatory requirements in different states. As a result, the risk profiles of each power plant are very different, and different financial products may be used to manage the risks associated with each asset. However, the Reproposal would require Entity A to manage the risks of the power plants jointly if it wished to receive BFH treatment. Entity A would not be permitted to allow its independent managers to make independent risk management decisions, even if they had different opinions on the appropriate manner in which to manage risk in the operation of a particular power plant.

> *Example 6 – Inventory Targets – Entity A holds inventory as a normal part of its business. Entity A has established target inventory levels, and any shortfall or surplus compared with these targets is managed as a price risk exposure. For example, assume Entity A has 10 million barrels of crude oil storage capacity available at a facility and has established a target inventory level of 5 million barrels. If actual inventory is only 4 million barrels, Entity A has a 1 million barrel short inventory price risk position. The Reproposal, however, would not provide BFH treatment if Entity A entered a long futures position to hedge this inventory shortfall, even though this shortfall represents the actual inventory price risk borne by Entity A.*

Accordingly, to prevent harm to a commercial firm's ability to hedge its exposure to physical price risk, the Commercial Alliance requests that the Commission withdraw its newly proposed interpretation of the Economically Appropriate Test, including Example 5 in Appendix C to proposed Part 150 of the CFTC's regulations, and instead continue to provide commercial firms flexibility in managing their risks as they deem appropriate in their business judgment. In this regard, any final rule issued by the Commission in this proceeding should clarify positions offsetting fixed or unfixed price risk incidental to a commercial enterprise's cash operations (*e.g.*, location, product, time, quality, execution, credit, weather, and government policy risk) will satisfy the Economically Appropriate Test. The commercial businesses and risk management practices of energy and agricultural firms are far too complex to adopt an interpretation of the Economically Appropriate Test that substitutes the experience of such commercial firms for the judgment of a government agency through a one-size-fits-all approach to risk management. If commercial firms are unable to hedge their risks in an efficient manner, prices for physical commodities will increase and ultimately be borne by consumers.

ii. *Commercial Hedgers Would Incur Significant Costs to Comply with the New Interpretation of the Economically Appropriate Test*.

As described above, commercial firms do not manage their risks as required under the CFTC's new interpretation of the Economically Appropriate Test because the new interpretation does not reflect actual (and prudent) risk management practices. Consequently, commercial firms currently do not have the IT systems or business processes needed to comply with the CFTC's new interpretation of the Economically Appropriate Test. If the CFTC determines to adopt this new interpretation, commercial firms would be required to implement IT systems and business processes for no other reason but to comply with the CFTC's new interpretation of the Economically Appropriate Test. In other words, commercial firms would incur unnecessary costs and burdens to track and report various cash positions that bore no relation to their prudent risk management practices. Accordingly, the Commercial Alliance recommends that, if the CFTC determines to adopt a new federal speculative position limits framework, it should not adopt this new

interpretation of the Economically Appropriate Test.

2. The List of Enumerated BFHs in CFTC Regulation 150.1 is Overly Restrictive and Should Be Expanded.

i. *The Enumerated BFHs Should Be Expanded to Include Certain Risk-Reducing Practices Commonly Utilized in Energy and Agricultural Markets.*

The Reproposal declines to adopt an enumerated BFH exemption for anticipated merchandising activity even though Congress included "merchandising" and "anticipated merchandising" in the statutory BFH definition alongside "production, processing, and manufacturing."[23] Specifically, the CEA states that a BFH includes hedges against the "potential change in value of assets that a person owns, produces, manufactures, processes, or *merchandises* or *anticipates* owning, producing, manufacturing, processing or *merchandising*."[24] In doing so, Congress recognized merchandising and anticipated merchandising as equally critical to the physical supply chain as producing, processing, and manufacturing. The Commercial Alliance agrees with Congress's recognition, as the physical supply chain needs merchandisers to ensure commodities are efficiently moved from one location to another where they are needed most. Like a producer drilling wells or a processor building refineries, a merchandiser makes a substantial commitment of capital, staffing, and expertise to its commercial business.

The Commercial Alliance has presented in the Comment Letters, BFH Petition, and at CFTC meetings numerous examples of hedges of merchandising and anticipated merchandising activity.[25] Rather than repeat them herein, the Commercial Alliance incorporates them by reference.[26] These examples represent legitimate, non-speculative, risk-reducing practices commonly utilized in commodity markets that meet the statutory BFH definition set forth in CEA Section 4a(c)(2), as the Commission previously has recognized. Indeed, the Commission expressly recognized in its enumerated BFH list under the 2011 final speculative position limits rule, which was vacated on other grounds,

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23 *See* CEA Section 4a(c)(2)(A).

24 *See* CEA Section 4a(c)(2)(A)(iii)(I) (emphasis added).

25 *See* The Commercial Energy Working Group presentations and comments provided at the CFTC's July 29, 2015 EEMAC meeting, https://www.youtube.com/watch?v=xpE-sthXOws&feature=youtu.be; February 26, 2015 EEMAC meeting, https://www.youtube.com/watch?v=yGLWQsuqZ-w&feature=youtu.be; and June 19, 2014 Position Limits Roundtable, https://www.youtube.com/watch?v=jx5ZryxlRsI&feature=youtu.be; https://www.youtube.com/watch?v=pbKC8GJeQGU&feature=youtu.be; *see also* July 13th Letter, Attachment 1, Nos. 8-14; February 10th Letter, Sections IV.B-C, E, G, at 16-26, 27-28, 29-37; BFH Petition; Revised Request for Exemptive Relief No. 7.

26 *See id.*

hedges of anticipated merchandising activity, including, for example, hedges of unfilled storage capacity.[27]

The Commercial Alliance submits that, if these commonly utilized risk-reducing practices are added to the list of enumerated BFHs, market participants utilizing exemptions for these enumerated BFHs would be subject to appropriate safeguards and a robust regulatory structure that exists today. The Exchanges would continue to monitor trading in physical commodity derivatives markets and surveil their markets for anomalies to prevent manipulation, price distortion, disruptions of the delivery or cash-settlement process, and position limit violations.[28] The Exchanges also would continue to oversee applications for BFH exemptions from Exchange-set limits, which could be rejected at any time if the Exchange believes the exemptions no longer are appropriate.[29] Further, market participants would be required to file with the CFTC Series '04 reports[30] and keep records of cash positions related to exemptions from speculative limits.[31] At all times, market participants would continue to be prohibited by the CFTC and Exchanges from engaging in disruptive trading practices[32] and market manipulation,[33] and the Commission and Exchanges would be able to use their anti-manipulation and anti-disruptive practices authority to investigate potential market abuse resulting from hedging exemption violations as well as their authority to seek more information related to speculative position limit exemptions.[34]

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[27] *See Position Limits for Futures and Swaps*, Final Rule and Interim Final Rule, 76 Fed. Reg. 71,626, at 71,646 (Nov. 18, 2011), *vacated*, *Int'l Swaps and Derivatives Ass'n v. U.S. Commodity Futures Trading Comm'n*, 887 F. Supp. 2nd 259 (D.D.C. Sept. 28, 2012), *appeal dismissed*, 2013 U.S. App. LEXIS 22618 (D.C. Cir. Nov. 6, 2013).

[28] *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).

[29] *See, e.g.*, NYMEX Rule 559; CBOT Rule 559; IFUS Rule 6.29; NFX Rule Ch. V, Sec. 13.

[30] See proposed CFTC regulations 19.01, 150.3(a)(3), 150.7.

[31] See proposed CFTC regulation 150.3(g).

[32] *See* CEA Section 4c(a)(5); *Antidisruptive Practices Authority*, Interpretative Guidance and Policy Statement, 78 Fed. Reg. 31,890 (May 28, 2013); *see also* NYMEX Rulebook, Interpretations & Special Notes Relating to Chapter 5, http://www.cmegroup.com/rulebook/NYMEX/1/5.pdf; IFUS Rulebook, Chapter 4, https://www.theice.com/publicdocs/rulebooks/futures_us/4_Trading.pdf; NFX Rule Ch. III, Sec. 24, http://nasdaqphlx.cchwallstreet.com/NASDAQPHLXTools/PlatformViewer.asp?selectednode=chp_1_1_1_5&manual=%2Fnasdaqomxphlx%2Fnfx%2Fphlx-brdtrade-rules%2F.

[33] *See* CEA Sections 6(c) and 9(a); *see also* NYMEX Rulebook, Interpretations & Special Notes Relating to Chapter 5, http://www.cmegroup.com/rulebook/NYMEX/1/5.pdf; IFUS Rulebook, Chapter 4, https://www.theice.com/publicdocs/rulebooks/futures_us/4_Trading.pdf; NFX Rule Ch. III, Sec. 24, http://nasdaqphlx.cchwallstreet.com/NASDAQPHLXTools/PlatformViewer.asp?selectednode=chp_1_1_1_5&manual=%2Fnasdaqomxphlx%2Fnfx%2Fphlx-brdtrade-rules%2F.

[34] *See* proposed CFTC regulations 150.3(h), 150.7(c); *see also, e.g.*, NYMEX Rule 559; CBOT Rule 559; IFUS Rule 6.29.

In light of the above, there is no legal or policy reason for distinguishing merchandising or anticipated merchandising from other activity in the physical supply chain. The Commercial Alliance therefore urges the Commission to reduce the administrative costs and burdens associated with the hedge exemption process and expand the list of enumerated BFHs to include hedges, including in physically-delivered Referenced Contracts held in the last five days of trading or the spot month, of the following activity:

- anticipated purchases and sales, where a merchandiser has a demonstrable history of buying, transporting, storing, blending, or selling the commodity;
- bids and offers that are binding and will require the party to make or take delivery at a stated, fixed price;
- the value of assets, such as energy and agricultural infrastructure, owned or anticipated to be owned;
- the value of storage capacity 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;
- 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;
- 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;
- 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;
- unfixed price commitments used to ensure supply or outlet for products that will be purchased or sold before or through the spot month;[35]
- unfixed priced requirements and unfixed priced production;[36]

[35] *See* March 30th Letter, Sections III.C.4-6, at 15-16, and Attachment 2; August 4th Letter, Section II.A.3, at 5-6; February 10th Letter, Section IV.B, at 16-26.

[36] *See* August 4th Letter, Sections II.A.3, III.C, at 5-6,10-14; February 10th Letter, Section IV.D, at 26-27.

- unfixed priced requirements for utility (or other similar entity designated as a sole provider or provider of last resort) customers;[37]
- calendar month average pricing hedges, including in the spot month;[38]
- anticipated cash transactions subject to ongoing good-faith negotiations; and[39]
- commodity transactions priced as differentials.[40]

While adopting enumerated BFH exemptions for the commercial activities described above would provide market participants more legal and administrative certainty, the Commission should, at a minimum, expressly permit the Exchanges to recognize a NEBFH or spread exemption for merchandising and anticipated merchandising activity. The Exchanges have the experience, expertise, regulatory infrastructure, incentives, and obligation to effectively administer exemptions from federal position limits.[41]

ii. *The CFTC Should Not Apply the Five-Day Rule to Any BFH Exemption.*

The Reproposal applies the Five-Day Rule to several enumerated BFHs.[42] The application of the Five-Day Rule would prevent commodity market participants from receiving BFH exemptions for commonly used risk-reducing practices that involve hedges in physically-delivered Referenced Contracts held during the last five days of trading or the spot month. The Commercial Alliance has thoroughly discussed and presented numerous examples demonstrating the circumstances where a commercial firm would need to hold a hedge, including a cross-commodity hedge, in the spot month.[43] Because market facts and circumstances often exist that require a commercial firm seeking to effectively manage its price risk to hold into the spot month certain hedge positions that utilize physically-

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37 *See* March 30th Letter, Attachment 2, slides 11-13; February 10th Letter, Section IV.E, at 27-28.

38 *See* March 30th Letter, Attachment 2, slides 14-28; August 4th Letter, Section III.C, at 10-14; February 10th Letter, Section IV.G, at 29-37.

39 *See* August 4th Letter, Section III.C, at 10-14; February 10th Letter, Section IV.C, at 26.

40 *See* February 10th Letter, Section XV, at 68-70.

41 *See* July 13th Letter, Section II.A, at 2-4.

42 *See* March 30th Letter, Attachment 1, Nos. 20-21; February 10th Letter, Section VII, p. 51-53 (providing a list of the enumerated BFHs applying the Five-Day Rule).

43 *See* July 13th Letter, Section II.B.2, at 7-9; March 30th Letter, Section III.C.5, at 15-16; August 4th Letter, Section III.B, at 8-10; February 10th Letter, Sections VI.B-VII, at 47-53.

delivered Referenced Contracts,[44] the application of the Five-Day Rule on a blanket basis is neither appropriate nor justified and would severely disrupt physical commodity markets.[45] Importantly, the Commission has recognized that the Five-Day Rule is not appropriate in all circumstances,[46] and the Exchanges in their discretion often grant exemptions to speculative position limits in the last five days of trading and the spot month.

Accordingly, the Commercial Alliance requests that any final rule adopted in this proceeding eliminate the Five-Day Rule from any and all enumerated BFHs, including those described above in Section III.C.2.i should the CFTC determine to adopt them as enumerated BFHs.[47] If the Commission declines to adopt this request, it should, at a minimum, and as set forth in the Reproposal, permit the Exchanges on a case-by-case basis to waive the Five-Day Rule and provide a NEBFH or spread exemption for positions in physically-delivered Referenced Contracts held in the last five days of trading or spot month that would otherwise qualify for an exemption.

3. Accountability Levels, Which Currently Are Applied in an Effective Manner to Physical Commodity Derivatives Markets, Should Be Adopted Instead of New Non-Spot Month Speculative Position Limits.

The Commercial Alliance appreciates the Commission's determination in the Reproposal to increase the level of the initial non-spot month speculative position limits. However, as stated above in Section III.A.1, absent a specific finding that new federal non-spot month speculative position limits are necessary to prevent excessive speculation in a specific commodity derivatives contract market, the Commission should refrain from adopting such speculative limits. Should the Commission determine to proceed in adopting a new federal speculative position limits framework, the Commercial Alliance believes

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[44] For example, a market participant may need to hold in the spot month a cross-commodity hedge 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 sales contract) that is being hedged must be held or priced through the spot month. *See* August 4th Letter, Section III.B, at 10; February 10th Letter, Sections VI.B-VII, at 47-51.

[45] *See* July 13th Letter, Section II.B.2, at 7-9; March 30th Letter, Section III.C.5, at 15-16 and Attachment 2, slides 14-28; August 4th Letter, Section III.B, at 10; February 10th Letter, Sections VI.B-VII, at 47-53.

[46] *See Definition of Bona Fide Hedging and Related Reporting Requirement*, Final Rules, 42 Fed. Reg. 42,748, 42,749 (Aug. 24, 1977) (stating that "persons wishing to exceed [speculative position] limits during the last five trading days may submit materials supporting classification of the position as *bona fide* hedging pursuant to paragraph [1.3(z)](3) of the newly adopted definition").

[47] While the Reproposal does not apply the Five-Day Rule to spread exemptions, the 2016 Supplemental Proposal requests comment on whether the Five-Day Rule should be applied to spread exemptions. *See* 2016 Supplemental Proposal, Requests for Comment Nos. 7-9 and 20-22. For the reasons stated above, the Commission should not apply the Five-Day Rule to any spread exemption from federal speculative position limits.

accountability levels are more appropriate than non-spot month speculative position limits for purposes of monitoring non-spot month positions in energy and agricultural markets. Energy markets (and some non-legacy agricultural markets) currently operate efficiently without non-spot month speculative position limits and under accountability levels administered by DCMs.

Further, although the Reproposal utilizes swap data collected under Part 20 of the CFTC's regulations to establish the proposed initial non-spot month speculative limits, the CFTC notes in the Reproposal that the Commission "continues to be concerned about the quality of [such] data."[48] Given the proposed non-spot month speculative limits also would apply to swaps, it is critical that the Commission have reliable open interest data on cleared and uncleared swaps before establishing new non-spot month speculative position limits.[49]

In establishing the proposed initial non-spot month speculative limits, the Reproposal provides Tables III-B-14 and III-B-20 and states that the Commission's impact analyses for establishing such speculative limits for agricultural and energy contracts are summarized in the tables. The Commercial Alliance submits, however, that the impact analyses presented in Tables III-B-14 and III-B-20 are lacking and raise substantial concerns. For example, Table III-B-14 represents that, in Year 1 (July 1, 2014 – June 30, 2015), 10 or more "Unique Persons" would have exceeded the proposed all month speculative limit for MWE, CT, IFUS Cocoa ("**CC**"), and IFUS Sugar No. 11 ("**SB**"), and 5 or more "Unique Persons" would have exceeded the proposed single month speculative limit for KW, MWE, CC, CT, and SB. Additionally, Table III-B-20 represents that, in Year 1, 8 "Unique Persons" would have exceeded the proposed all months speculative limit for the NYMEX RBOB Gasoline ("**RB**") contract, 7 "Unique Persons" would have exceeded the proposed single month speculative limit for RB,[50] and 6 "Unique Persons" would have exceeded the proposed all months speculative limit for the NYMEX New York Harbor ULSD ("**HO**") contract.[51]

Yet the Reproposal fails to explain how often or by how much the "Unique Persons" would have exceeded the proposed non-spot month speculative limits; nor does the Reproposal explain whether the "Unique Persons" were engaging in "excessive speculation" that would have caused "sudden or unreasonable fluctuations or unwarranted changes in the price" of the commodity.[52] While the Commission may believe these numbers seem low, these few persons could hold liquidity that is beneficial to the applicable markets, including additional liquidity in thinly traded Referenced Contracts or

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48 *See* Reproposal at 96,759.

49 *See* February 10th Letter, Section XI, at 60-62.

50 *See* Reproposal at 96,769.

51 *See id.*

52 *See* CEA Section 4a(a)(1).

contract months. As reflected in Tables III-B-14 and III-B-16, if the Commission adopts the proposed non-spot month speculative position limits, several agricultural and energy commodities markets would suffer potential liquidity losses. The Commercial Alliance submits that removing from these markets *any* liquidity that does not pose the risks associated with excessive speculation is inappropriate, contrary to the basic requirements of the Dodd-Frank Act, and harmful to commodity markets that are operating efficiently and without excessive speculation.

In light of the foregoing, the Commercial Alliance recommends that the Commission delegate to the Exchanges authority to administer accountability levels and delay the implementation of new non-spot month speculative position limits until such time the Commission believes accountability levels no longer adequately protect against excessive speculation.[53] DCMs have significant expertise and experience in preserving orderly markets and have the resources needed to monitor the size of market participants' positions.[54]

4. The Proposed Reporting Requirements Should Be More Narrowly Tailored and Align with Commercial Hedging Practices.

i. *Form 204*.

The Commercial Alliance believes the information required to be reported on Form 204 should be limited only to information that will assist the Commission in assessing the validity of a claimed BFH exemption. As proposed, Form 204 appears to require a bona fide hedger to report all cash positions of the entire commercial enterprise of which it is part even if certain cash positions do not justify the claimed BFH exemption.[55] A proposed reporting requirement seeking information not relevant to a BFH exemption would provide no regulatory benefit to the Commission and impose unnecessary costs and burdens on bona fide hedgers. The Commercial Alliance submits that new IT systems and business processes would have to be implemented to comply with the Form 204 reporting requirements, if adopted as proposed. The costs and resources necessary to collect and report all cash positions of the entire commercial enterprise would be substantial, especially for large companies with global trading affiliates and desks.[56]

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53 For further discussion of this recommendation, see March 30th Letter, Section III.A.3, at 8-10.

54 *See* CFTC regulations 37.600-01 (SEF Core Principle 6) (requiring SEFs to implement and enforce speculative position limits and accountability levels to reduce the threat of market manipulation and congestion (especially in the delivery month); 38.300-01 (DCM Core Principle 5) (requiring the same of DCMs).

55 *See* March 30th Letter, Section III.C.7, at 16-18.

56 Some members of the Commercial Alliance believe it will take one full-time employee equivalent to collect the relevant information and submit the Form 204.

Accordingly, given existing Form 204 (applicable to legacy agricultural contracts) is more appropriately tailored than the Form 204 proposed under the Reproposal, the Commercial Alliance reiterates its recommendation that the Commission retain its existing Form 204 with the following modifications:[57]

- Proposed CFTC Regulation 19.00(b)(1) and Form 204 should be modified to parallel the Commercial Alliance's recommendations with respect to the interpretation of the Economically Appropriate Test. That is, a reporting person should be expressly permitted to calculate its cash positions in accordance with its regular business practice and report on Form 204 only the cash positions it considered in making its BFH determinations. In this regard, a person could exclude from Form 204 source commodities, products, byproducts, and inventory and contracts of the actual commodity if it is the regular business practice of the reporting person to exclude such in considering cash positions for hedging purposes.

- Form 204 should be modified to require filing of the form 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.

- The Commission should issue guidance akin to the guidebook published for Large Trader Reporting under Part 20 of the CFTC's regulations[58] to aid market participants in their attempts to prepare Form 204 and build systems to collect the information that must be provided on Form 204.[59]

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[57] *See* July 13th Letter, Section III.C.2, at 17-18.

[58] If the CFTC declines to adopt the Commercial Alliance's recommendations regarding Form 204, significant uncertainty in the scope and applicability of certain terms provided in proposed CFTC regulation 19.01(a)(3) (*i.e.*, "commodity hedged" and "products and byproducts") will exist among participants in physical commodity markets and CFTC staff members. For example, in a hedge of physical crude oil using a NYMEX Light Sweet Crude Oil ("**CL**") contract, the term "commodity" set forth in proposed CFTC regulation 19.01(a)(3) could mean: (i) all grades of crude oil that are listed as being deliverable under the 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.

[59] The Commercial Alliance also requests that the CFTC adopt existing CFTC Form 304 with the modifications described above.

ii. *Form 704*.

The Reproposal would require bona fide hedgers to submit to the CFTC a proposed Form 704 if they sought an exemption for an enumerated anticipatory BFH along with annual updates to the Form 704 reflecting the applicant's actual cash market activities related to the anticipated exemption. Bona fide hedgers also would be required to report monthly on Form 204 any remaining unsold, unfilled, or other anticipated activity.

If the Commission expands the list of enumerated BFHs under proposed CFTC regulation 150.1 to include the various risk-reducing positions commonly utilized in physical commodity markets, such as derivatives positions hedging anticipated merchandising activity, market participants will be required to submit proposed Form 704. If the Commission declines to adopt these positions as enumerated BFHs, the market participant would be required to apply to the Exchanges under the Exchange Exemption Process for a NEBFH exemption.

In light of the above, the Commission should not make the reporting requirements for enumerated anticipatory BFHs more onerous than the application requirements for NEBFH exemptions under the Exchange Exemption Process. In this regard, the Commission should eliminate from any final rule adopted in this proceeding the requirement to file a Form 704 and simply retain the Forms 204 and 304 reporting requirements (modified as described above). Importantly, because a bona fide hedger is required to keep records of its hedged cash market positions, the CFTC may obtain access to such records upon request should it suspect a market participant is abusing an anticipatory BFH exemption.[60]

D. To Preserve Efficient Commercial Hedging Activity, Further Revisions to the Exchange Exemption Process, Referenced Contract Definition, and Pass-Through Exemption are Necessary.

As described above, if the Commission determines to establish a new federal speculative position limits framework after finding them necessary and appropriate, it should adopt the four major revisions discussed above addressing the BFH definition, non-spot month speculative position limits, and reporting requirements for bona fide hedgers. Additionally, the Commercial Alliance believes other technical changes to the Reproposal are necessary to protect commercial hedging practices and recommends that the Commission:

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[60] *See* proposed CFTC regulations 150.3(h), 150.7(c).

- Modify the Exchange Exemption Process to (i) permit the Exchanges to provide retroactive exemptions from federal speculative position limits, and (ii) alleviate the Exchanges' reporting requirements;

- Require the Exchanges to provide an exhaustive list of Exchange-listed Referenced Contracts and update the list of location basis contracts; and

- Clarify that the exemption for a pass-through swap and offset may be utilized by all affiliates in an affiliated group.

1. The Exchange Exemption Process Should Not Be Unnecessarily Restrictive.

The Commercial Alliance supports the Commission's efforts to develop a framework that relies upon the Exchanges to administer the Exchange Exemption Process. Utilizing the Exchanges in this manner will allow commercial market participants to effectively manage their risks and the Commission to fulfill its regulatory objective in preventing excessive speculation. However, the Commercial Alliance requests that the Commission adopt certain modifications to the Exchange Exemption Process.

i. *Exchanges Should Be Permitted to Provide Retroactive Exemptions from Federal Speculative Position Limits.*

The Reproposal should be modified to allow Exchanges to provide retroactive exemptions for NEBFHs, enumerated anticipatory BFHs, and spread positions. Certain facts and circumstances may warrant retroactive exemption, such as, where a market participant (i) experiences an abrupt and unexpected change in its underlying commercial business or (ii) inadvertently exceeds a speculative position limit with a non-speculative position for which an exemption would have been available had an application been timely filed. Commission-approved Exchange rules currently allow the Exchanges to grant retroactive exemptions,[61] and the Reproposal also would allow Exchanges to grant retroactive exemptions for products traded on their markets and not subject to federal speculative limits.[62]

Accordingly, the Commercial Alliance recommends that the Commission afford the Exchanges discretion in appropriate circumstances to provide after a market participant has exceeded an applicable federal speculative position limit exemptions for NEBFHs, enumerated anticipatory BFHs, and spread positions. Under this recommendation, the

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61 *See, e.g.*, NYMEX Rule 559; IFUS Rule 6.13 (allowing the Exchanges to grant a speculative position limit exemption to market participants in violation of an applicable Exchange-set speculative limit if the market participant files an exemption application within five days of exceeding the applicable speculative limit).

62 *See* proposed CFTC regulation 150.5(b)(5)(i)(B).

Commission would retain its authority to review the Exchanges' determinations.

ii. *Exchange Reporting Requirements Should Be Eliminated or Reduced*.

Under the proposed Exchange Exemption Process, Exchanges would be required to report to the Commission (i) a weekly report describing various details of their determinations in providing NEBFH, enumerated anticipatory BFH, and spread exemptions[63] and (ii) copies of any report required to be submitted to the Exchange by a market participant seeking an exemption under the Exchange Exemption Process.[64] As stated above, the Commercial Alliance believes that utilizing the Exchanges Exemption Process will benefit commercial market participants by allowing them to more effectively manage their risks in a timely manner.

The Commercial Alliance is concerned, however, that such benefit might be limited if the requirements placed upon the Exchanges are so onerous as to deter them from administering the Exchange Exemption Process. Importantly, Exchanges would be required to keep records of exemption applications, reports submitted by applicants updating their applications, and any records related to the Exchanges' determinations on such applications,[65] and the Commission would have access to such records upon request.[66] In this light, the Commercial Alliance recommends that the Commission eliminate the Exchange reporting requirements or, at a minimum, reduce the frequency of such reporting.

iii. *The Exchange Exemption Process Under Proposed CFTC Regulation 150.11 Should Apply to All Enumerated Anticipatory BFH Positions*.

Under proposed CFTC regulation 150.11, Exchanges would be permitted to recognize certain enumerated anticipatory BFH positions. Consistently, in providing proposed CFTC regulation 150.11, the Commission has indicated it finds the Exchanges equipped to administer exemptions for enumerated anticipatory BFH positions. Thus, if the CFTC adopts the Commercial Alliance's recommendation to expand the list of enumerated BFH positions under proposed CFTC regulation 150.1 to include hedges of the commonly used risk-reducing practices described above in Section III.C.2.i, the CFTC also should permit the Exchanges under proposed CFTC regulation 150.11 to recognize such BFHs if they are anticipatory (*e.g.*, hedges of anticipated merchandising activity).

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63 *See* proposed CFTC regulations 150.9(c)(1); 150.10(c)(1); 150.11(c)(1).

64 *See* proposed CFTC regulations 150.9(c)(2); 150.10(c)(2).

65 *See* proposed CFTC regulations 150.9(b); 150.10(b); 150.11(b).

66 *See* proposed CFTC regulations 150.9(d)(1); 150.10(d)(1); 150.11(d)(1).

2. More Clarity Should Be Provided on the "Referenced Contract" Definition.

The Commercial Alliance supports the Reproposal's determination to exclude from the "Referenced Contract" definition, among others, trade options meeting the requirements of CFTC regulation 32.3 and location basis contracts as defined in proposed CFTC regulation 150.1. The Commercial Alliance also appreciates the Commission's efforts to publish a list of Referenced Contracts. Yet the proposed list of location basis contracts in Appendix B to proposed Part 150 of the CFTC's regulations is outdated and reflects the difficulty in keeping such list updated. The Commercial Alliance recommends that before any final rule is adopted in this proceeding, the Exchanges should be required to update the list of location basis contracts as well as the list of Referenced Contracts for the contracts that the Exchanges list, as they are best positioned to determine the universe of such contracts. More certainty and interpretational consistency will result if commercial firms are not required to determine whether Exchange-traded contracts are Referenced Contracts or exempt location basis contracts.

3. Exemptions for Pass-Through Swaps and Offsets Should Be Provided to All Affiliates in a Corporate Family.

Some corporate families utilize a specific affiliate (sometimes referred to as a "central hedging affiliate") to manage the corporate family's risks. Under the Reproposal, in the case where a firm executes a swap opposite a pass-through swap counterparty (*i.e.*, a bona fide hedger), such firm would receive a pass-through exemption (*i.e.*, BFH treatment) for both the swap executed opposite the pass-through swap counterparty and the derivatives contract it must use to offset the risk of the pass-through swap. However, if the firm transfers the risk of the pass-through swap to a central hedging affiliate that in turn hedges such risk in the market through a derivatives contract, it is not clear that the inter-affiliate transaction or the central hedging affiliate's market-facing derivatives transaction would qualify for the pass-through swap and offset exemptions, respectively. The Commercial Alliance believes these transactions should qualify for the pass-through swap and offset exemptions because the net result on the market is no different than if the original entity had hedged the risk in the market itself.

Accordingly, the Commercial Alliance requests that the Commission clarify that within an aggregated group of companies, the exemptions for pass-through swaps and offsets will pass through to inter-affiliate transactions and market-facing transactions in which an affiliate of a corporate family hedges the risk of the original transaction.

E. Any Final Speculative Position Limits Rule Adopted in this Proceeding Should Provide a Phased-In Compliance Schedule that Would Provide the Exchanges and Commercial Hedgers Sufficient Time to Come into Compliance.

Under the Reproposal, the compliance date of any final rule adopted in this proceeding would be delayed until, at the earliest, January 3, 2018.[67] The Commercial Alliance believes that, at this point, a January 3, 2018 compliance date is unrealistic. If the Commission determines to adopt a new final speculative position limits rule, the Commercial Alliance submits that the Exchanges will need sufficient time to (i) develop new rules implementing the Exchange Exemption Process, which will require prior approval from the Commission before they go into effect, (ii) design business processes and systems to administer such new rules, and (iii) review and approve new applications under this process. Similarly, while market participants currently comply with Exchange-set speculative position limits and exemptions, they likely will need to develop and implement new IT systems and business practices to comply with the regulatory differences under the new federal speculative position limits framework, which, as described above, is substantially different than the current environment for energy and non-legacy agricultural derivatives.

The Commercial Alliance therefore recommends that market participants be given at least nine months from the date that the Exchanges adopt Commission-approved rules implementing the Exchange Exemption Process to comply with new spot month speculative position limits. If the Commission determines to adopt new federal non-spot month speculative position limits, the Commercial Alliance 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 Exchange Exemption Process.

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67 *See* Reproposal at 96,727.

IV. CONCLUSION.

The Commercial Alliance appreciates the opportunity to provide comments on the Reproposal and requests that the Commission consider the comments set forth herein as it develops any final rule in this proceeding.

The Commercial Alliance expressly reserves the right to supplement these comments as deemed necessary and appropriate. Please contact the undersigned with questions.

Respectfully submitted,

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