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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.

Castleton Commodities International LLC ("**CCI**") appreciates the opportunity to submit this letter commenting on the Reproposal, *Position Limits for Derivatives,* issued by the Commodity Futures Trading Commission (the "**CFTC**" or **"Commission**") in the above-referenced proceeding and published in the *Federal Register* on December 30, 2016.[1] The Reproposal sets forth a potential framework for establishing new federal speculative position limits for certain physical commodity derivative transactions 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**").[3]

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

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[1] *See Position Limits for Derivative,* Reproposal*,* 81 Fed. Reg. 38,458 (Dec. 16, 2016) ("Reproposal").

[2] 7 U.S.C. § 6a(a).

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

CCI submits this limited set of comments to address specific aspects of the Reproposal and, more broadly, the potential impacts on the ability of commercial market participants to effectively manage their risks under the proposed federal position limit structure for energy commodities. In addition, CCI generally supports the joint comment letter addressing the Reproposal submitted by The Commercial Energy Working Group and the Commodity Markets Council (collectively, the "**Commercial Alliance**") in this proceeding.

II. EXECUTIVE SUMMARY.

CCI appreciates the Commission's efforts to address concerns and issues raised by CCI and other commercial market participants in this proceeding. Consistent with our prior comments, CCI believes that an appropriately-tailored federal speculative position limits regulation may have a place in the Commission's regulatory framework.[4] However, the statutory requirements of Sections 4a(a)(1) and 15(a) of the Commodity Exchange Act (**"CEA"**) and other provisions of federal law require the Commission to present adequate justification as a predicate to adopting position limits for any enumerated commodity.

We believe the Reproposal lacks requisite justification for the imposition of federal speculative position limits on the enumerated energy commodities. We note that the primary impetus for the Commission's initial proposal in 2009 and each subsequent release in this rulemaking proceeding, including this Reproprosal, was the hypothesis that prices for essential energy and other commodities were being determined by speculative trading rather than supply and demand fundamentals. That notion has been belied by more recent performance of the energy markets, which demonstrated a high degree of responsiveness to changes in demand. The recent history of the energy markets demonstrated that the speculators acted based on fundamental signals of supply and demand dynamics.

To the extent that the Commission concludes based on the required analysis that limits are necessary to diminish, eliminate or prevent burdens of excessive speculation, CCI presents the comments herein with respect to the terms of limits set forth in the Reproposal. Importantly, and notwithstanding the improvements embodied in the Reproposal, CCI remains concerned that aspects of this regime likely would have material and adverse impacts on our ability to hedge exposures to physical price risk in an effective manner or would impose unwarranted and excessive costs to such activities. Increased costs to commercial hedgers ultimately will be borne by end-users of these important commodity products. In order to mitigate this concern, we believe it essential that the Commission take the steps outlined below to ensure that any final rule issued in this proceeding (i) is workable from a practical, operational perspective, and (ii) poses limited restriction on (a) the ability of firms (including CCI) to hedge exposures to price risks and/or (b) does not impair the efficient functioning of markets for energy commodity derivatives:

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[4] *See Comments of Castleton Commodities International LLC Comment Letter Re: Supplemental Notice of Proposed Rulemaking*, *Position Limits for Derivatives: Certain Exemptions and Guidance*, RIN 3038-AD99 (July 13, 2016) ("Supplemental Comments").

- **Cost-Benefit Analysis**. Undertake a new and thorough cost-benefit analysis that meets the requirements of CEA Section 15(a) before adopting any new regulation as part of any final rule issued in this proceeding. We believe the cost-benefit analyses provided in the Reproposal substantially underestimates certain costs that would be imposed upon CCI and other commercial hedgers, particularly in regard to the process of seeking Exchange Exemptions from applicable federal speculative position limits.

- **Five-Day Rule**. Withdraw the "**Five-Day Rule**" that prohibits market participants from holding positions in physical-delivery Referenced Contracts for the enumerated energy commodities during the spot month as enumerated *bona fide* hedge positions ("**BFHs**"), as non-enumerated BFHs ("**NEBFHs**") or as certain spread transactions ("**Spread Exemptions**"). We believe any potential regulatory benefits of such a rule are vastly outweighed by the direct harm it would have on the price discovery process and the costs to commercial market participants seeking to use these Referenced Contracts to hedge legitimate commercial risks.[5]

- **Economically Appropriate Test**. Adhere to the Commission's long-standing practice of affording market participants discretion to exercise their business judgment and take into consideration their experience in the application of the "economically appropriate to the reduction of risk in the conduct and management of a commercial enterprise" limitation of the BFH definition ("**Economically Appropriate Test**").

- **Exchange Recognition of All Commission-Approved Exemptions**. Clarify that Exchanges must recognize and, where supported by facts and circumstances, grant all exemptions that have been approved or otherwise sanctioned by the Commission.

- **Spot Month Limits and Phased Implementation**. Limit the implementation of the proposed framework set forth in the Reproposal for federal speculative position limits to spot months, the point at which price convergence is required. To the extent the Commission nevertheless does decide to impose single non-spot month and all-months-combined limits (collectively, "**Any and All Month Limits**"), we urge that the Commission refrain from implementing such limits until (i) spot month limits have been adopted and the Commission has determined them to be functioning smoothly, and (ii) the Commission has made a necessity finding with respect to each commodity for which Any and All Month Limits have been proposed.

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

III. <u>COMMENTS OF CASTLETON COMMODITIES INTERNATIONAL LLC</u>.

A. The Commodity Exchange Act Requires the Commission to Conduct a New and Thorough Cost Benefit Analysis Before Issuing a Final Rule in this Proceeding.

CCI is concerned that the Reproposal seeks to implement various requirements and regulations as part of a final rule without making an adequate and appropriate determination consistent with the requirements of CEA Section 15(a) that the benefits of imposing federal speculative position limits to energy commodities outweigh the costs. In particular, several aspects of the Reproposal appear to underestimate by a substantial amount the compliance and other costs that will be incurred by CCI and other commercial market participants. Moreover, the Reproposal does not contain adequate consideration of the potential harm to commercial hedging practices and disruption to the efficient operations of liquid, physical commodity markets that would result from the imposition of position limits.

Of particular concern, the Reproposal underestimates by orders of magnitude the costs that will be incurred by CCI and other commercial market participants seeking relief from applicable federal speculative position limits when applying for Exchange Exemptions. With respect to the time required to prepare applications for Exchange Exemptions, the Reproposal estimates the burden imposed on market participations at 4 hours for NEBFHs, 5 hours for Anticipatory BFHs, and 3 hours for Spread Exemptions. In contrast, CCI estimates that its own recent applications to Exchanges have taken between 7 and 15 hours ***per contract***.

Applying for a significant number of the relevant and related contracts for an enumerated energy commodity subject to federal speculative position limits (required to effectively access liquidity and engage in appropriate spreads) can result in at least 90 hours by personnel of a commercial market participant applying to a single Exchange, which can still require tens of hours in responses to any questions from the Exchange. These estimates do not include any time or cost involved in developing and maintaining special systems or reports required to support such efforts, or external legal advice.

For a commercial firm engaged in transactions across a broad range of energy products, the burden would multiply with each individual energy Referenced Contract subjected to federal speculative position limits. CCI estimates that the internal time burden imposed by the Reproposal just for obtaining and maintaining necessary exemptions could easily exceed 400 hours per year. Based on this, CCI conservatively estimates that the actual time and cost to prepare applications for Exchange Exemptions is approximately 30x greater than figures set forth in the Reproposal – exclusive of the additional internal and external resources/costs associated with the application process as noted above.

B. CCI Urges the Commission Not to Apply the "Five-Day Rule" on a Blanket Basis to Enumerated BFHs, NEBFHs and Spread Exemptions in Energy Markets.

As expressed in its Supplemental Comments, CCI does not support application in the Reproposal of the Five-Day Rule to a commercial market participant seeking NEBFH or Spread Exemptions using a physically-delivered Referenced Contract for the enumerated energy commodities in the spot month.[6] The Five Day Rule is a carryover from the CFTC's existing Part 150 regulations which apply to a small group of enumerated *agricultural commodities*, which if applied on a blanket basis to enumerated BFHs, NEBFHs and Spread Exemptions would severely disrupt energy markets. Energy markets are characterized by a greater number of commercial hedger and holders of spread positions that utilize exchanges to settle Reference Contracts than markets for contracts on agricultural commodities.

The Exchanges on which physically-delivered Referenced Contracts are listed have significant experience in promoting the integrity of the settlement process and will continue to be best positioned to protect the orderly functioning of their markets under a federal speculative position limits regime applicable to energy commodities. CCI appreciates the Commission's concerns regarding disorderly liquidations of exempt-sized positions of physical-delivery Referenced Contracts in the spot month. However, the adoption of the Five-Day Rule as an absolute restriction with respect to all enumerated BFHs, NEBFHs and or Spread Exemptions will drive much needed liquidity away from the critical price-formation contracts during closing period. The lack of any economic rationale for requiring a commercial energy market participant to exit a physically-delivered Referenced Contract that provides the most effective, best correlated hedge and move its position into an economically equivalent cash-settled Referenced Contract, or go unhedged, further highlights the arbitrary nature of this proposed requirement.

Accordingly, CCI strongly urges the Commission to withdraw the Five-Day Rule from any enumerated BFH, NEBFH, or Spread Exemption. Given the potential adverse consequences to energy markets and the limited benefit of this restriction, CCI believes this restriction is arbitrary and without appropriate justification.

If the Commission elects to impose the Five-Day Rule notwithstanding this request, we urge the Commission to adopt the recommendation in CCI's Supplemental Comments and 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.[7]

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[6] Supplemental Comments at 8-9.

[7] Supplemental Comments at 8-9.

C. Afford Market Participants the Continuing Ability to Identify and Reduce Their Exposures to Price Risk as They Deem Appropriate in Their Business Judgment.

In order for a position or transaction to qualify as a BFH under the Reproposal, it must satisfy the Economically Appropriate Test as set forth in the definition of BFH in proposed CFTC Regulation 150.1. CCI encourages the Commission to affirm its long-standing practice of allowing market participants to make reasoned determinations with respect to how they analyze their exposures to price risks, value those risks and endeavor to mitigate them through the use of Reference Contracts to the extent they deem appropriate in their business judgment based on their experience. To the extent that a market participant values one set of identified risks exposures differently than a separate and distinct set of risk exposures within its physical commodity portfolio, the market participant should continue to be permitted to hedge risks in particular portions of its business and be accorded BFH treatment for such positions.

This approach to *bona fide* hedging was clearly contemplated by the Commission when codifying the definition of BFH set forth in existing CFTC Regulation 1.3(z) and is embodied in the current language of CEA Section 4a(c)(2).[8] Further, it is consistent with how the Exchanges have historically viewed the hedging of commercial risks for which market participants have sought BFH exemptions from Exchange-set limits.[9] However, this approach was more recently called into question by text in the notice of proposed rulemaking issued by the Commission in this proceeding in December 2013,[10] and we encourage the Commission to promote greater understanding among market participants of this requirements by reaffirming its long-standing interpretation of this standard.

The Exchanges, acting under the Commission's oversight, have routinely granted commercial enterprises BFH exemptions related to the price risks arising from their activities associated with a complex mix of exposures to different commodities, grades of commodities, locations, processing and production facilities, and access to transportation infrastructures.[11] Importantly, the Exchanges have recognized that, depending on the circumstances, it may be economically appropriate to hedge or manage certain price risks but not others, given the variety of risk sources. Under certain circumstances, a hedge transaction may shift risk (without increasing overall risk) from one business line to another business line.

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[8] *See Commodity Futures Trading Commission, Hedging Definition Development and Contemporary Issues*, Blake Imel, Ronald Hobson, and Paula Tosini, Working Paper Series #CSFM-119, Oct. 1985, citing 17 C.F.R. 33.6(c) (1984).

[9] See CME Group Inc. Comment Letter Re: Notice of Proposed Rulemaking, Position Limits for Derivatives, RIN No. 3038-AD99 (Feb. 14, 2014) at 61-62.

[10] *See Position Limits for Derivatives*, Notice of Proposed Rulemaking, 78 Fed. Reg. 75,680 at 75,709 (Dec. 13, 2013).

[11] *See CME Group Inc. Comment Letter Re: Notice of Proposed Rulemaking, Position Limits for Derivatives*, RIN No. 3038-AD99, at 61 (Feb. 10, 2014).

Given the absence of any historical abuse of the Economically Appropriate Test documented by the Commission or by the Exchanges, and the lack of any evidence that the misapplication of this test has led to excessive speculation that must be eliminated, CCI requests that the Commission continue to provide commercial market participants with flexibility to identify and reduce their exposures to price risk when and how they deem appropriate.

D. Exchange-Recognition of Commission-Approved Exemptions.

Under the Reproposal Exchanges would be permitted to make preliminary determinations as to whether certain transactions qualify as Exchange Exemptions and, thus, may be exempted from federal speculative position limits. CCI requests that the Commission clarify that any Exchange authorized to make such preliminary determinations must recognize and, if supported by the appropriate facts and circumstances, grant all Commission-approved or otherwise sanctioned exemptions from such limits.

CCI believes this clarification is required to promote uniformity with respect to the BFH framework incorporated into the proposed regime for federal speculative position limits and to avoid "regulatory arbitrage" by market participants seeking to avail themselves of the most advantageous Exchange Exemption process. In this respect, the Exchanges should not be permitted – explicitly or implicitly – to selectively determine whether or not they would accept and preliminarily grant applications for a type of exemption previously approved or sanctioned by the Commission, when the appropriate facts and circumstances support such action.

For example, if one Exchange grants a calendar spread exemption, as allowed under the Reproposal, but another Exchange does not, a market participant would not be able to use economically equivalent Referenced Contracts in calendar spreads across the two Exchanges. As a result, the market would lose the benefit of the price convergence and liquidity provided by such positions. Further, any one Exchange would be able to effectively re-interpret or limit the CFTC's rulemaking for its own purposes by maintaining selectively more restrictive standards than contemplated by the Reproposal. This issue is particularly acute where only one Exchange offers a physically-settled Reference Contract – in this instance, the Exchange can prevent effective arbitrage trades between the physical contract and more liquid contracts on other Exchanges, which could result in lack of proper convergence between such contracts and harm to market efficiency.[12]

E. Spot Month Limits and Phased Implementation.

To the extent that, after making required necessity findings and conducting the requisite cost-benefit analysis, the Commission proceeds with a final rule in this proceeding, CCI strongly urges the Commission to expressly restrict the scope and applicability of federal speculative position limits regime to spot month limits only. Although CCI does not oppose the

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[12] As part of any cost benefit analysis undertaken by the Commission prior to adopting new regulations, the Commission must consider, among other things, the efficiency, competitiveness, and financial integrity of futures markets pursuant to CEA Section 15(a)(2)(B).

implementation of adequately justified and appropriately scoped federal speculative position limits, such a regime must first be adequately justified. In this respect, the Reproposal does not define the term "excessive speculation;" nor does it make a finding that Any and All Month Limits are necessary to prevent excessive speculation in each commodity market for which the Commission would implement such limits.[13]

To the extent that the Commission determines that Any and All Month Limits are required to diminish, prevent or eliminate the burdens of excessive speculation, CCI strongly urges the Commission to do so using a phased-in approach. In this regard, we would expect the Commission first to implement and observe the effects of spot month limits before determining that limits on Any and All Months are actually necessary. The Exchanges will need time to develop new market rules with respect to the application and reporting process associated with Exchange Exemptions. Such market rules will also require Commission approval. Moreover, market participants will require time to develop, test and implement systems designed to facilitate compliance with federal speculative position limits. Consequently, we believe that it would be appropriate to adopt Any and All Month Limits only after spot month limits have been fully implemented and deemed to be functioning smoothly.

IV. Conclusion.

CCI appreciates this opportunity to provide comments on the Reproposal and the Commission's consideration of these comments.

Respectfully submitted,

/s/ Steven M. Bunkin

Steven M. Bunkin, Esq.

Executive Vice President, General Counsel and Corporate Secretary

Castleton Commodities International, LLC

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[13] CEA Section 4(a)(1) does not mandate the adoption of federal speculative position limits as a prophylactic measure to prevent excessive speculation. Instead, Section 4a(a)(1) requires that the Commission specifically find whether federal speculative position limits are required to prevent an undue or unnecessary burden on interstate commerce caused by excessive speculation on a commodity-by-commodity basis. In addition to failing to define "excessive speculation," the Reproposal fails to provide any empirical data that excessive speculation exists for the enumerated energy commodities for which it proposes to implement Any and All Month Limits under the proposed federal speculative position regime. Accordingly, CCI urges the Commission not to adopt Any and All Month Limits until such time that the Commission defines the term "excessive speculation" and makes the requisite necessity find for each enumerated energy commodity for which such Any and All Month Limits would be imposed.