Suncor Energy Marketing Inc.
P.O. Box 2844
150 – 6th Avenue S.W.
Calgary, AB T2P 3E3
Tel 403-296-8000
Fax 403-296-3030
www.suncor.com

May 15, 2020

VIA ELECTRONIC SUBMISSION

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

Re: Proposed Rule, *Position Limits for Derivatives*, RIN 3038-AD99

Dear Secretary Kirkpatrick:

I. INTRODUCTION.

Suncor Energy Marketing Inc. ("**SEMI**") and Suncor Energy USA Marketing Inc. ("**SEUSAMI**") (SEMI and SEUSAMI are collectively referred to herein to as "**SEMI**") hereby submits this letter in response to the request for public comment set forth in the Commodity Futures Trading Commission's (the "**CFTC**" or "**Commission**") Proposed Rule, *Position Limits for Derivatives* (the "**Proposed Rule**") published in the *Federal Register* on February 27, 2020,[1] which proposes to establish federal speculative position limits for certain physical commodity derivatives 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**" or the "**Dodd-Frank Act**").[3]

SEMI and SESAUMI are wholly-owned subsidiaries of Suncor Energy Inc. ("**Suncor**"), an integrated energy company headquartered in Calgary, Alberta, Canada. The company is strategically focused on developing one of the world's largest petroleum resource basins – Canada's Athabasca oil sands. In addition, Suncor explores for, acquires, develops, produces and markets crude oil in Canada and internationally. SEMI is responsible for the commercial management of Suncor's integrated business model and the optimization of Suncor's hydrocarbon value chain bringing Suncor's production of crude oil, petroleum products and power to market, as well as sourcing feedstocks and energy for Suncor's refinery network from counterparties operating in North American and international energy markets. SEMI is also responsible for financial trading in U.S. commodity derivative markets for purposes of managing Suncor's exposure to price risk associated with its physical portfolios of crude oil, refined products, natural gas and LNG, as well as other energy commodities.

SEMI respectfully requests for the Commission to consider the comments provided herein and urges the Commission to bring this rulemaking proceeding to an ultimate conclusion through the issuance of a final rule as soon as possible.

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[1] Proposed Rule, *Position Limits for Derivatives*, 85 Fed. Reg. 11,596 (Feb. 27, 2020).

[2] 7 U.S.C. § 6a(a).

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

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II. COMMENTS OF SUNCOR ENERGY MARKETING INC.

A. The Proposed Rule Approaches the Commission's Goal of Preventing Excessive Speculation Without Harming Commercial Hedging Activity.

SEMI broadly supports the regulatory framework for federal speculative position limits set forth in the Proposed Rule. Structurally and substantively the Proposed Rule is a substantial step forward over the Commission's prior rulemaking proposals to ensure the Commission meets its statutory obligations under CEA Section 4a(a) to reduce or prevent excessive speculation and, at the same time, allowing commercial firms to effectively manage their exposure to price risk.[4] The following features in the Proposed Rule are examples of the Commission crafting fair and balanced position limit regulations:

- Delegating substantial authority to the Exchanges to implement and administer many important and nuanced aspects of the new federal regime for speculative position limits, including the administration of exemptions for certain "bona fide hedging transactions or positions" ("**BFH**") therefrom, subject to Commission oversight;
- Limiting the federal regime to spot month speculative limits in markets for energy commodity derivatives;
- Delegating authority to the Exchanges to impose accountability levels for non-spot months in energy markets;
- Recognizing more appropriate, updated deliverable supply estimates for purposes of establishing federal speculative position limits;
- Developing a workable definition of "economically equivalent swap";
- Expressly withdrawing the novel, overly narrow, and restrictive interpretation of the BFH definition proposed in the Prior Releases;
- Clarifying and adopting a commercially-practicable interpretation of the definition of BFH and issuing new guidance on the use of gross hedging that will allow hedgers to continue to use their discretion and business judgment to effectively identify and manage their exposures to price risk in physical commodity markets;
- Adopting an expanded list of enumerated hedge exemptions (each, an "**Enumerated BFH**"), including Anticipated Merchandising, and permitting a number of the proposed Enumerated BFHs to be utilized on a cross-commodity basis;
- Including a dual track process for commercial firms to pursue BFH exemptions that do not fall within any of the Enumerated BFHs set forth in the Proposed Rule (each, a "**Non-Enumerated BFH**") that permits commercial firms to apply for such exemptions (i) directly to the Commission, or (ii) using a streamlined process administered by the Exchanges;

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[4] *See* Reproposal, *Position Limits for Derivatives*, 81 Fed. Reg. 96,704 (Dec. 30, 2016) ("**Reproposal**"); Supplemental Notice of Proposed Rulemaking, *Position Limits for Derivatives: Certain Exemptions and Guidance*, 81 Fed. Reg. 38,458 (June 13, 2016) ("**Supplemental Proposal**"); Notice of Proposed Rulemaking, *Position Limits for Derivatives*, 78 Fed. Reg. 75,680 (Dec. 12, 2013) ("**December 2013 Proposal**") (collectively, the "**Prior Releases**"). The Commission issued the Proposed Rule as a new proposal and, in doing so, has expressly withdrawn the Prior Releases from further consideration. Proposed Rule at 11,597.

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- Eliminating from federal position limits the prohibition on the ability to hold a physically-settled Referenced Contract as a BFH during the last five days of trading ("**Five Day Rule**");

- Including a BFH exemption for offsets of pass-through swap positions that qualify for treatment as BFHs;

- Including an exemption from applicable federal speculative position limits for certain enumerated spread transactions and for persons under financial distress;

- Excluding trade options from the Referenced Contract definition, and providing BFH treatment for Referenced Contracts that hedge trade options;

- Striking regulations such as CFTC Regulation 1.48 that required administrative process before a commercial firm might use certain anticipatory BFHs; and

- Eliminating monthly reporting of cash-market positions under Form 204 and the Series '04 Form reporting requirements applicable to BFH activity proposed in the Prior Releases.

Subject to comments set forth herein, SEMI believes this framework approaches a workable balance of meeting its statutory obligations to prevent excessive speculation under CEA Section 4a(a) and avoiding harm to legitimate commercial hedging activities. Given the current market environment in which the Proposed Rule is being considered, the Commission can help reassure participants in the energy market that markets for energy commodities will remain liquid and robust by providing the certainty of a final rule regarding federal speculative position limits based on this foundation.

B. Recommendations Intended to Provide Regulatory Certainty and Ensure the Ability of Commercial Firms to Effectively Manage Risk.

The comments submitted herein are limited in scope and specific. They are provided with the goal of constructively helping the Commission ultimately strike the balance referenced above by ensuring the federal regime provides commercial hedgers with the flexibility needed to effectively identify and hedge their exposures to price risk in the supply chain. By doing so, commercial hedgers will be better able to reduce risk and volatility as well as potentially the costs of physical commodities delivered to others that include end-use consumers at both corporate and retail levels.

1. Treatment of "Bona Fide Hedging Transactions or Positions."

As the trading and risk management function of a company with a large, complex physical energy portfolio, SEMI must take into account various important and unique considerations when hedging its exposures to price risk. Location, product, and timing characteristics all factor into the evaluation of risk, as do applicable corporate structures, hedging objectives, and each of these subjectively evaluate risks differently. Importantly, the Commission's clarified view of BFH activity does not involve the adoption of a "one-size-fits-all" approach to commodity risk management that substitutes pre-determined Commission limitations for discretion and business judgment of commercial firms. Instead, it provides commercial hedgers with flexibility to identify their risk exposures in physical commodity markets, value them, and manage such exposures in accordance with their risk appetite and business objectives, whether at the level of aggregated affiliates, legal entity, desk, book, asset, or other level.

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Suncor Energy Marketing Inc.
P.O. Box 2844
150 – 6th Avenue S.W.
Calgary, AB T2P 3E3
Tel 403-296-8000
Fax 403-296-3030
www.suncor.com

a. The Use of Gross Hedging Practices Should Be Permitted for Both Enumerated and Non-Enumerated Bona Fide Hedging Activities.

The Proposed Rule, through Appendix B, paragraph (a) of proposed Part 150, appropriately recognizes that gross hedges should qualify for BFH treatment in circumstances where net cash positions do not necessarily measure total risk exposure due to differences in the timing of cash commitments, the location of stocks, and differences in grades or types of cash commodity. Further, the Proposed Rule also recognizes that large entities with complex corporate structures, such as Suncor, may have hedging needs that are not met solely through the use of gross or net hedging.[5]

Gross hedging is a standard risk management practice that is used by a broad array of commercial energy firms to manage their exposure to price risk under the existing exchange regimes for position limits. With this in mind, the guidance set forth in Appendix B, paragraph (a)(1) with respect to gross hedging should clarify that gross hedging is permissible when using both Enumerated BFHs and Non-Enumerated BFHs in order to provide certainty that commercial hedgers, such as SEMI, are able to continue to utilize gross hedging practices as part of their routine BFH activities.

Although the Proposed Rule does not offer any discussion as to why gross hedging would not be appropriate in the context of Enumerated BFHs, SEMI is concerned that the preamble text and language of Appendix B, paragraph (a)(1)(D) addressing the use of gross hedging contemplates that such hedging activity could be limited to Non-Enumerated BFHs. In relevant part, the preamble text states as follows:

> The Commission continues to believe that a gross hedge may be a bona fide hedge in circumstances where net cash positions do not necessarily measure total risk exposure due to differences in the timing of cash commitments, the location of stocks, and differences in grades or types of cash commodity. However, the Commission clarifies that these may not be the only circumstances in which gross hedging may be recognized as bona fide. Like the analysis of whether a particular position satisfies the proposed bona fide hedge definition, *the analysis of whether gross hedging may be utilized would involve a case-by case determination by the Commission and/or by an exchange using its expertise and knowledge of its participants as it considers applications under § 150.9, subject to Commission review and oversight*.
>
> (Emphasis added).[6]

Further, the guidance in Appendix B, paragraph (a)(1) is set up as a four-part conjunctive test, and states as follows:

> (A) The manner in which the person measures risk is consistent over time with and follows a person's regular historical practice for that person;
>
> (B) The person is not measuring risk on gross basis to evade federal position limits set forth in § 150.2 or the aggregation rules in § 150.4;
>
> (C) The person is able to demonstrate compliance with paragraphs (A) and (B) upon request of the Commission and/or of designated contract market, including by providing information regarding the entities with which the person aggregates positions; and

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[5] Proposed Rule at 11,613.

[6] Proposed Rule at 11,613.

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(D) A designated contract market or swap execution facility that recognizes a particular gross hedging position as bona fide pursuant to § 150.9 documents the justification for doing so, and maintains records of such justifications in accordance with § 150.9(d).

SEMI is concerned that the express reference to proposed Regulation 150.9 in Appendix B, paragraph (a)(1) could be read as effectively prohibiting such firms from using gross hedging under the proposed federal regime unless they were able to obtain a Non-Enumerated BFH for such activity.

If commercial hedgers are limited to using gross hedging in this manner it would substantially undermine the Commission's efforts to provide commercial hedgers with additional flexibility to manage their risk exposures in an efficient and less burdensome manner through an expanded list of Enumerated BFHs. In addition, it will likely result in a large number of commercial hedgers being forced to seek Non-Enumerated BFHs for what they perceive as standard, day-to-day hedging practices, which would be contrary to the Commission's expectations that the Non-Enumerated BFH process would be utilized only in "rare and exceptional" circumstances.[7]

If it is the Commission's intent to allow commercial firms to use gross hedging when managing exposures covered by Non-Enumerated BFHs and/or Enumerated BFHs, SEMI requests that any final rule issued in this proceeding should remove paragraph (a)(1)(D) from the Appendix B gross hedging guidance and expressly clarify that commercial hedgers have the flexibility and discretion to use gross hedging for Enumerated or Non-Enumerated BFHs so long as the other conditions of paragraph (a)(1) are met.

b. Integrated Energy Companies Routinely Engaged in Merchandising Activities Should Be Permitted to Utilize Enumerated BFH for Anticipated Merchandising.

SEMI supports the adoption of an Enumerated BFH for Anticipated Merchandising in paragraph (a)(11) of Appendix A of proposed Part 150. Merchandising plays a critical role in the physical supply chain in every commodity market, linking producers to processors and processors to wholesalers and consumers.[8] SEMI and its affiliates own, operate, and otherwise control assets that facilitate the production, storage, and processing of physical energy commodities on a global scale.

As a stand-alone subsidiary of Suncor, SEMI functionally falls within the Supply, Trading and Optimization ("**STO**") business within Suncor's overall corporate structure. As part of its role within Suncor's STO business, SEMI effectively functions in the same manner as physical commodity merchants or supply chain logistic companies for purposes of engaging in the trading of physical energy commodities and energy commodity derivatives to optimize assets owned, operated or otherwise controlled by SEMI's affiliates and other Suncor functional business units whose operations are based in North America. In this capacity, SEMI regularly acts as a middleman in markets for energy commodities for purposes of purchasing and also maintains commercial relationships with unaffiliated third-parties for purposes of engaging in merchandising transactions for its own account.

The language proposed for the Enumerated BFH for Anticipated Merchandising, if strictly construed, could foreclose SEMI as an affiliate of an integrated energy company from utilizing this enumerated hedge exemption from federal position limits. Specifically, the Enumerated BFH for Anticipated Merchandising specifically refers to entities that are "merchants," which is undefined. SEMI respectfully submits that this hedge exemption should also apply to any commercial firms routinely

[7] Proposed Rule at 11,650.

[8] Proposed Rule at 11,611.

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engaged in the business of merchandising that can demonstrate the ability to make and take physical delivery of physical commodities as well as to store and move the underlying commodity.

SEMI appreciates the diverse set of Enumerated BFHs available to commercial firms that can be utilized to facilitate the hedging needs of various aspects of their business, such as upstream and downstream operations. However, SEMI cautions the Commission to be careful and not to overlook the need for commercial firms that regularly engage in the business of merchandising to seek relief from federal position limits for such activities through the Enumerated BFH for Anticipated Merchandising.

Without the ability to utilize the Enumerated BFH for Anticipated Merchandising, SEMI would be required to seek a Non-Enumerated BFH directly from the Commission pursuant to proposed Regulation 150.3 or an Exchange pursuant to proposed Regulation 150.9 to put on anticipated merchandising hedge positions above applicable federal position limits. *Such a limitation would have the unintended consequence of competitively disadvantaging SEMI and other commercial energy firms who routinely engage in the merchandising of physical commodities to entities that would be permitted to utilize this enumerated exemption on the terms proposed*. SEMI does not believe that this is the Commission's intent. Further, given the lack of certainty and timing concerns associated with the proposed Non-Enumerated BFH process, it would also potentially inject additional risk into the energy supply chain. Increased risk will result in increased costs, which will ultimately be borne by consumers of energy commodities.

In light of these concerns, the Commission should revise the Enumerated BFH for Anticipated Merchandising set forth in Appendix A, paragraph (a)(11) to apply to any commercial hedger that is genuinely engaged in the business of merchandising and has a demonstrated history of buying and selling the underlying commodity for its merchandising business.[9]

c. The Commission Should Clarify That the Enumerated BFHs for Anticipated Unfilled Requirements and Anticipated Merchandising May Be Utilized as Cross-Commodity Hedges.

As noted in Section II.A, above, SEMI supports the adoption of Appendix A, paragraph (a)(5) which permits commercial hedgers to utilize a large number of the proposed Enumerated BFHs as cross-commodity hedges.[10] However, the Proposed Rule's failure to expressly include the Enumerated BFHs for Unfilled Anticipated Requirements and Anticipated Merchandising as cross-commodity hedges will limit legitimate commercial hedging activity, particularly for commercial firms with large, complicated energy commodity portfolios.[11]

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[9] SEMI generally supports the following proposed revision to Appendix A, paragraph (a)(11)(B) of the Enumerated BFH for Anticipated Merchandising set forth in the comments being filed with the Commission in this proceeding by The Commercial Energy Working Group and offers a substantially similar revision:

> (B) The person ~~is a merchant~~ handling the underlying commodity that is subject to the anticipatory merchandising hedge **is a producer, processor, commercial user, or a merchant (a "Commercial Entity")**, and that ~~such merchant~~ **such Commercial Entity** is entering into the position solely for purposes related to its merchandising business and has a demonstrated history of buying and selling the underlying commodity for its merchandising business.

[10] Specifically, pursuant to paragraph (a)(5) in Appendix A of proposed Part 150, a market participant may utilize the following Enumerated BFHs listed in Appendix A on a cross-commodity basis: (i) hedges of unsold anticipated production; (ii) hedges of offsetting unfixed-price cash commodity sales and purchases; (iii) hedges of anticipated mineral royalties; (iv) hedges of anticipated services; (v) hedges of inventory and cash commodity fixed-price purchase contracts; (vi) hedges of cash commodity fixed-price sales contracts; (vii) hedges by agents; and (viii) offsets of commodity trade options.

[11] The Enumerated BFH for Unfilled Anticipated Requirements and Anticipated Merchandising are respectively set forth in Appendix A, paragraphs (a)(10) and (a)(11).

SUNCOR ENERGY

Suncor Energy Marketing Inc.
P.O. Box 2844
150 – 6th Avenue S.W.
Calgary, AB T2P 3E3
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Fax 403-296-3030
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The Proposed Rule does not provide any basis for the omission of Unfilled Anticipated Requirements and Anticipated Merchandising from the list of Enumerated BFHs in Appendix A, paragraph (a)(5). However, SEMI highlights an internal inconsistency between this omission in the Proposed Rule and the Commission's preliminarily determination that Request No. 10 set forth in the 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**") would potentially fit in paragraph (a)(5) of the Appendix A, if applicable requirements are met. Request No. 10 of the BFH Petition involves holding a cross-commodity hedge using a physically-settled Referenced Contract to meet unfilled anticipated requirements.[12]

SEMI supports the Commission's preliminary determination with respect to Request No. 10 that such hedging activity would qualify for BFH treatment as a cross-commodity hedge of unfilled anticipated requirements. For commercial energy firms transacting in cash markets for crude oil or refined products, it is industry-standard practice to use commodity derivatives contracts, including physical-delivery futures contracts (*i.e.,* physically-settled Referenced Contracts), to hedge their unfulfilled anticipated requirements for a particular underlying commodity on a cross-commodity basis. The following examples illustrate commonly-utilized cross-commodity hedges by a number of commercial energy firms that warrant treatment either under the Enumerated BFHs for Unfilled Anticipated Requirements or Anticipated Merchandising:

- Refining. North American refiners commonly use the NYMEX light sweet crude oil (CL) futures contract, a physically-settled Referenced Contract, to hedge price risk exposure associated with a grade(s) of crude oil that they anticipate purchasing as feedstock for its refining operations, including grades of crude oil that are not deliverable under the technical specifications of the NYMEX CL futures contract.[13] For example, a refiner may import cargoes of crude oil from Africa or the Middle East to process through its U.S.-based refinery network. While these grades of crude oil are not technically deliverable under the NYMEX CL futures contract, the NYMEX CL futures contract is viewed as the best available hedge due to the price correlation with imported crude oil and the significant liquidity of the market in which it is traded.

- Aviation "Jet" Fuel. Commercial energy firms may have contractual commitments to supply airlines, airports, or the Department of Defense with aviation fuel (*i.e.,* jet fuel). Such firms may not have the operational capability to refine or otherwise process jet fuel and are required to meet their sales commitments through third-party purchases of this energy commodity. Similar to the gasoline blending scenario above, there is no recognized, liquid commodity derivative contract for jet fuel. As such, the standard industry practice is to use the NYMEX NY Harbor ULSD (HO) futures contract as a cross-commodity hedge due to its price correlation with physical jet fuel prices and the liquidity in the NYMEX HO futures market.

SEMI recognizes that there are differences between asset classes of commodity derivative contracts, such as those transacted in energy and agricultural markets. These differences are largely related to operational differences in how markets for physically-settled energy and agricultural Referenced Contracts trade. It is SEMI's understanding that, as a general matter, the Commission has concerns about potential disruptions to market integrity associated with participants holding long positions in the spot month in futures markets agricultural commodities. These concerns form some of the basic underpinnings of the Five-Day Rule applied to certain enumerated agricultural futures contracts

[12] Proposed Rule at 11,612. *See* The Commercial Energy Working Group's BFH Petition can be found at: http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgbfhpetition012012.pdf

[13] *See* NYMEX Rule 200.

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P.O. Box 2844
150 – 6th Avenue S.W.
Calgary, AB T2P 3E3
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Fax 403-296-3030
www.suncor.com

(referred to as the legacy physically-settled, agricultural Referenced Contracts under the Proposed Rule). However, as addressed for other reasons in Section II.B.1.e, below, these concerns do ***not*** exist in energy markets from an economic or operational perspective.

Based on the foregoing, there is no policy basis for the Commission to require energy market participants to seek Non-Enumerated BFHs from the Exchanges pursuant to proposed Regulation 150.9 or from the Commission pursuant to proposed Regulation 150.3 for cross commodity hedges of Unfilled Anticipated Requirements or Anticipated Merchandising. Requiring commercial energy firms to pursue Non-Enumerated BFHs for such industry-standard, day-to-day risk management activities will not only harm legitimate hedging activity in energy markets by injecting uncertainty and delay into the process, it will likely result in a deluge of Non-Enumerated BFHs applications being submitted by a broad array of commercial energy firms which would be in contrast to the Commission's expectation that the Non-Enumerated BFH process would only be utilized in "rare and exceptional" circumstances.

Accordingly, SEMI requests that the Commission revise the express language of Appendix B, paragraph (a)(5) to specifically clarify that Enumerated BFHs for Unfilled Anticipated Requirements and Anticipated Merchandising may be utilized as cross-commodity hedges in energy markets. SEMI offers the following revisions to Appendix A, paragraph (a)(5) for the Commission's consideration:

> (5) *Cross-commodity hedges*. Positions in commodity derivative contracts described in paragraph (2) of the bona fide hedging transactions or positions definition in § 150.1 or in paragraphs (a)(1) through (a)(4), ~~and~~ paragraphs (a)(6) through (a)(9), and**, with the exception of positions in legacy and other agricultural core referenced futures contracts identified in Table 1 to paragraph (d) of §150.2, paragraphs (a)(10) and (a)(11)** of this appendix A may also be used to offset the risks arising from a commodity other than the cash commodity underlying a commodity derivative contract, provided that the fluctuations in value of the position in the commodity derivative contract, or the commodity underlying the commodity derivative contract, shall be substantially related to the fluctuations in value of the actual or anticipated cash position or pass-through swap.

d. The Commission Should Clarify That Certain Commonly-Utilized, Industry-Standard, Risk Reducing Practices Fall within the Proposed Enumerated BFH for Anticipated Merchandising.

Notwithstanding its general support for the regulatory framework contemplated for federal position limits, SEMI is concerned that the Proposed Rule fails to recognize certain industry-standard, commonly utilized hedges of merchandising activity as falling within the Enumerated BFH for Anticipated Merchandising in Appendix A, paragraph (a)(11) to proposed Part 150. In order to avoid harm to commercial hedging activity in energy markets, the Commission should expressly clarify that the Enumerated BFH for Anticipated Merchandising may be utilized for the frequently-utilized, industry-standard hedges of merchandising activity outlined below.

Requiring commercial hedgers to pursue Non-Enumerated BFHs from the Exchanges pursuant to proposed Regulation 150.9 or directly from the Commission pursuant to proposed Regulation 150.3 for the commonly-utilized, industry standard risk-reducing practices discussed below will inject uncertainty and impose additional costs to commercial hedging activities in energy markets. Moreover, if an enumerated exemption for these activities is not available, it is foreseeable that the Exchanges and the Commission will be overwhelmed with Non-Enumerated BFH applications which would be contrary to the expectation articulated in the Proposed Rule that the Non-Enumerated BFH process would be used only in "rare and exceptional" circumstances.

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Suncor Energy Marketing Inc.
P.O. Box 2844
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Calgary, AB T2P 3E3
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Fax 403-296-3030
www.suncor.com

(i). Storage Hedges and Hedges of Assets Owned or to Be Owned.

Energy storage is a highly-valuable energy infrastructure asset. Storage hedges represent legitimate and fundamental risk reduction activity and are a frequently utilized risk-reducing practice across all sectors of the energy industry. A wide array of commercial energy firms from each sector of the energy industry including, but not limited to multinational energy companies, independent refiners, physical commodity merchants, power generation companies and regulated utilities rely on storage hedges.

The Proposed Rule suggests that commercial energy firms seeking to utilize storage hedges could pursue an exemption under the Non-Enumerated BFH process. However, in light of the pervasive use of storage hedges by entities throughout the physical supply chain and the Commission's approach to BFH activities in the Proposed Rule it would support the concept that a storage hedge should be included as an Enumerated BFH for Anticipated Merchandising. Additionally, the Proposed Rule does not provide any explanation or policy-based justification why such hedging activity would not fall within the Enumerated BFH for Anticipated Merchandising.

Storage hedges enable commercial hedgers to reduce exposure to price risk with respect to a commodity that is purchased and injected into storage as well as withdrawn and sold to customers, and they also help establish (and lock in) the value of the asset – the storage lease. The ability of a commercial hedger to protect itself from an adverse change in prices that determine an asset's value is clearly contemplated by the language of CEA Section 4a(a)(c)(2)(A)(iii)(1), which directs the Commission to define "*bona fide* hedging transaction or position to include the hedging of the value of assets that a party owns."

The omission of enumerated treatment for storage hedges in the Proposed Rule sharply contrasts with the treatment of this activity in the Vacated Final Rule.[14] The Vacated Final Rule included an enumerated hedge exemption that was characterized as anticipated merchandising in then proposed Part 151 of the CFTC Regulations, but which expressly applied to storage transactions.[15] In relevant part, the Vacated Final Rule stated as follows:

> The Commission recognizes that in some circumstances, such as when a market participant owns or leases an asset in the form of storage capacity, the market participant could establish market positions to reduce the risk associated with returns anticipated from owning or leasing that capacity. In these narrow circumstances, the transactions in question may meet the statutory definition of a bona fide hedging transaction. However, to address Commission concerns about unintended consequences (*e.g.*, creating a potential loophole that may result in granting hedge exemptions for types of speculative activity), the Commission will recognize anticipatory merchandising transactions as a bona fide hedge, provided the following conditions are met: (1) the hedger owns or leases storage capacity; (2) the hedge is no larger than the amount of unfilled storage capacity currently, or the amount of reasonably anticipated unfilled storage capacity during the hedging period; (3) the hedge is in the form of a calendar spread (and utilizing a calendar spread is economically appropriate to the reduction of risk associated with the anticipated

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[14] On November 18, 2011, the CFTC issued a final rule establishing federal speculative position limits for 28 exempt and agricultural commodity futures and options contracts and their economically equivalent contracts. *See* Final Rule and Interim Final Rule, *Position Limits for Futures and Swaps*, 76 Fed. Reg. 71,626 (Nov. 18, 2011) ("**Vacated Final Rule**"). On September 28, 2012, the United States District Court for the District of Columbia vacated and remanded this final rule. *See Int'l Swaps and Derivatives Ass'n, et al. v. U.S. Commodity Futures Trading Comm'n*, 887 F. Supp. 2d 259 (D.D.C. Sept. 28, 2012), *appeal dismissed*, 2013 U.S. App. LEXIS 22618 (D.C. Cir. Nov. 6, 2013).

[15] Vacated Final Rule at 71,646.

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Fax 403-296-3030
www.suncor.com

merchandising activity) with component contract months that settle in not more than twelve months; and (4) no such position is maintained in any physical-delivery Referenced Contract during the last five days of trading of the Core Referenced Futures Contract for agricultural or metal contracts or during the spot month for other commodities.[16]

Although storage hedges can be static, commercial energy firms often make dynamic decisions about how and when to hedge storage capacity.[17] Moreover, the market value of storage is largely determined by the calendar spread at that moment. Not allowing commercial energy firms to utilize these industry-standard hedges on an enumerated basis because they are "anticipatory" in nature or viewed as a form of "merchandising" – or both – could result in storage assets being underutilized, which could increase volatility in physical and financial markets for energy commodities that ultimately could translate into higher costs for consumers.

Accordingly, SEMI respectfully requests that any final rule issued in this proceeding clarify that hedges of storage may qualify for the Enumerated BFH for Anticipated Merchandising.

(ii). Hedges of Calendar Month Average Purchases and Sales.

The use of calendar month average ("**CMA**") pricing structures are favored in a vast amount of commercial transactions entered into by producers to sell, and end-use consumers (including refiners) to purchase, physical crude oil and natural gas. CMA pricing structures are used to (i) establish the spot price based on a differential to the forward price when there is no reliable market-established price, and (ii) convert to "trading month average" pricing (*i.e.,* the expiring listed futures contract does not trade through the delivery month).

Although producers in oil and gas markets could use the Enumerated BFH for Unsold Anticipated Production set forth as Appendix A, paragraph (a)(1) of proposed Part 150, to hedge sales of oil or gas to cover production sold using CMA Pricing, SEMI notes that firms to whom they might sell such production for resale to others cannot.[18]

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[16] Vacated Final Rule at 71,646. Subsequent to the Vacated Final Rule, in 2013, the Commission's focus on storage hedges shifted to providers of "off-farm" storage and the rents they could collect from operating storage capacity made available for use by commercial firms. *See* December 2013 Release at 75,719. This was not the basis pursuant to which the Commission considered and approved an anticipated merchandising hedge for storage in the Vacated Final Rule and should not be the basis that it is considered herein. Specifically, unlike the Vacated Final Rule, the December 2013 Release did *not* consider the storage hedge from the perspective of a commercial firm that (i) has purchased, or anticipates purchasing or (ii) has entered into, or anticipates entering into, binding agreements to utilize storage capacity specifically for purposes of optimizing its transaction activity in physical commodity markets or its production or processing operations.

Given the capital intensive nature of owning a storage facility (*i.e.,* fixed cost of the storage facility and the variable costs for labor and fuel, in addition to other costs such as insurance), SEMI is not in the business of acting as a third-party lessor of storage capacity and would *not* consider storage leased to unaffiliated third-parties as part of its own portfolio of physical commodity price risk exposures. Rather, SEMI utilizes storage that it owns, anticipates owning, leasing or anticipates leasing for purposes of optimizing flows associated with its transaction activity in global physical energy markets, as well as its production and refining businesses. Accordingly, the Commission should consider the instant request for clarification in this context, which is materially different (and clearly distinguishable) from when the Commission last addressed this issue in the December 2013 Release.

[17] These factors include, among others: (i) facility-specific operating characteristics; (ii) weather; (iii) regional storage constraints; (iv) pipeline maintenance; (v) "force majeure" events; and (vi) weekly U.S. Energy Information Administration natural gas storage numbers.

[18] This issue was first raised in Request No. 7, Scenario 2 of the BFH Petition filed by The Working Group of Commercial Energy Firms. *See* Proposed Rule at 11,611.

Suncor Energy Marketing Inc.
P.O. Box 2844
150 – 6th Avenue S.W.
Calgary, AB T2P 3E3
Tel 403-296-8000
Fax 403-296-3030
www.suncor.com

The Proposed Rule suggests that a commercial energy firm can seek a Non-Enumerated BFH to hedge merchandising transactions of energy commodities where the underlying transaction uses CMA pricing.[19] As a purchaser and reseller of crude oil and natural gas, this constraint would impair the ability of commercial energy firms to hedge against price risk associated with supply chain transactions (i) that utilize this critical pricing structure, or (ii) where an actual or potential mismatch in pricing terms exists and hedges using CMA pricing are viewed as the best available practice for mitigating exposure to such risks. Moreover, this statement fails to recognize that CMA pricing of physical oil or gas merchandising transactions is a prevailing, industry-standard practice in oil and gas markets.

Simply put, the pricing of physical transactions in oil and gas markets using CMA and the hedging of such transactions using this pricing is not the exception – rather it is the norm. In this respect, clarification that the Enumerated BFH for Anticipated Merchandising by commercial firms – whether merchants or integrated energy companies - that utilize CMA hedges to mitigate their exposure to price risk associated with the purchase of crude oil or natural gas from producers and resale of such product to third-parties down the supply chain will eliminate unnecessary barriers for obtaining BFH treatment related to a fundamental pricing practice in physical markets for oil and gas.

Accordingly, SEMI requests that the Commission clarify that hedges of underlying physical transactions that utilize CMA pricing structures may fall within the Enumerated BFH for Anticipated Merchandising in set forth in Appendix A, paragraph (a)(11) or other Enumerated BFH identified by the Commission.

(iii). Transactions Designed to Lock Basis Differentials Associated with Unpriced Purchase and Sale Commitments.

As a commercial energy firm, SEMI uses commodity derivatives to manage price risk associated with the purchase and sales of physical energy commodities, including situations in which it has entered into a purchase (or sale) transactions before it has arranged an off-setting sale (or purchase) transaction. Often such purchase and sale transactions can have a timing mismatch as they are not executed simultaneously. Rather, such transactions are undertaken with the expectation that the commodity will be moved from the location where it was purchased to another location where (i) the commodity is trading at a premium, and/or (ii) SEMI has established commercial relationships with producers, refiners or consumers.

This particular transaction structure forms the very basis in which energy commodities move from Europe to North America, from North America to the Caribbean, Latin and South America or from North America to Asia, and *vice versa*. Waiting until there is a match of buyer and seller before entering into commodity derivative transactions to hedge exposure to adverse price changes between these locations is not commercially practicable. To ensure the economics of the transaction, SEMI and other commercial energy firms will enter into one side of a transaction before arranging the other and use commodity derivative contracts as hedges to "lock the basis," *i.e.,* lock in the price differential between these locations by taking a long position in a commodity derivatives contract on the price index against which the commodity was purchased and sell a derivative on the expected sales price index (or *vice versa*).

SEMI is concerned that the Proposed Rule does not recognize enumerated hedge status for this critically important hedging practice in global energy markets and requests that the Commission clarify that hedges of transactions designed to lock in basis differentials associated with unpriced purchase and sale commitments fall within the Enumerated BFH for Anticipated Merchandising set forth in Appendix A, paragraph (a)(11) of proposed Part 150.

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[19] Proposed Rule at 11,612.

Suncor Energy Marketing Inc.
P.O. Box 2844
150 – 6th Avenue S.W.
Calgary, AB T2P 3E3
Tel 403-296-8000
Fax 403-296-3030
www.suncor.com

In sum, forcing commercial energy firms to seek Non-Enumerated BFHs for each of the industry-standard and commonly-utilized anticipated merchandising hedges described in this Section II.B.1.d., above will have the unintended consequence of overwhelming the Exchanges and Commission with applications for such BFH exemptions. Worse still, such action could have a chilling effect on commercial hedging activities as firms may need to curtail such practices while waiting for the Non-Enumerated BFH application process to reach a conclusion (and one for which there is critical uncertainty in the outcome). Ongoing uncertainty with respect to the timely (or ultimate) approval of Non-Enumerated BFHs for hedges of storage, CMA price hedges and hedges of transactions designed to lock in basis differentials associated with unpriced physical purchase or sale commitments would force commercial energy firms to price in such risk into the underlying physical transaction. This would result in (i) a higher volatility in prices for energy commodities and (ii) the risk of such physical market transactions potentially not occurring.

e. The Five Day Rule.

(i). The Commission Should Adopt an Outright Prohibition on the Application of the Final Rule to Physically-Settled Referenced Contracts for Energy Contracts.

SEMI fully supports the Commission's preliminary determination to remove the Five Day Rule from the proposed regulatory framework for federal speculative position limits.[20] Further, it appreciates and supports the proposed delegation of authority pursuant to proposed Regulation 150.5(a)(2)(ii)(4)(D) allowing the Exchanges to use their discretion to impose the Five Day Rule or other measures intended to ensure the fair, orderly, and efficient expiry of spot-month, physically-settled Referenced Contracts. However, SEMI requests that any final rule issued in this proceeding expressly clarify that the Five Day Rule does not apply to markets for energy commodity derivatives.

The restrictions against holding a physically-settled Referenced Contract as a BFH into the spot month is a carryover from the Commission's historic Part 150 regulations, which apply to legacy agricultural contracts. Such a restriction is neither appropriate nor justified given the unique operational characteristics of energy markets. Unlike markets for agricultural futures, physically-settled Referenced Contracts for energy commodities do not trade into the delivery month. Rather, these contracts cease trading days before the delivery month begins. As an example, for the NYMEX CL futures contract, market participants holding an expired NYMEX CL futures contract (expiry and trading end at least three days prior to the 25th calendar day of the calendar month PRIOR to the delivery month) are required to EFP out of that position the day after expiry or they go to physical delivery in the next calendar month. As the FCMs are ultimately responsible for the physical delivery of their clients, the operational risk of delivery in the spot month is nonexistent. Consequently, the risk that a party could be called upon during the spot period to fulfill a delivery obligation akin to that in agricultural futures markets when it is not commercially prepared to do so does not exist.

Furthermore, by forcing commercial energy firms to exit a position in a physically-settled Referenced Contract that is being held as a BFH in the spot month prior to expiry potentially exposes the firm to unnecessary price risk for which the BFH was entered into in the first place. In addition, it will unnecessarily thin liquidity which would result in increased price volatility during the spot month and leave the contract exposed to potential manipulation. For these reasons and the fact there is not an operational risk of delivery in the spot month, as discussed above, there is no apparent economic justification for forcing participants in energy markets to exit a physically-settled Referenced Contract that provides the best hedging tool into a different contract month or into a cash-settled Referenced

[20] Proposed Rule at 11,612-13.

SUNCOR ENERGY

Suncor Energy Marketing Inc.
P.O. Box 2844
150 – 6th Avenue S.W.
Calgary, AB T2P 3E3
Tel 403-296-8000
Fax 403-296-3030
www.suncor.com

Contracts. SEMI notes that there is no rational basis for applying the Five Day Rule in markets for energy commodity derivatives whether at the federal level or as part of exchange-set limits.[21]

Finally and importantly, in circumstances of extraordinary market conditions, such as what happened recently with the expire of the May 2020 NYMEX CL futures contract, the Exchange has at its disposal a set of tools that include the ability to request that any party holding a position that the Exchange believes could have a detrimental effect on the market to exit such a position prior to expiry. A final rule should not be created to be overly restrictive or create uncertainty for participants in response to the recent, unprecedented market conditions in WTI oil markets, when the Exchanges have the expertise, experience and existing tools to effectively manage the orderly expiration of futures contracts that are in the spot month under such circumstances.

(ii). The Waiver Guidance Set Forth in Appendix B, Paragraph (b) Should Only Apply to Physically-Settled Referenced Contracts Expressly Designated by an Exchange as Subject to the Five Day Rule.

Should the Commission decline to include in a final rule an express prohibition on the application of the Five Day Rule to energy commodity derivative contracts, SEMI requests that it clarify that an Exchange is not bound to apply the waiver guidance set forth in Appendix B, paragraph (b) to any physically-settled Referenced Contract that has not been expressly designated as subject to the Five Day Rule. Neither the Proposed Rule nor the proposed text of the waiver guidance in Appendix B, paragraph (b) address the specific circumstances pursuant to which the Exchanges would be expected to follow such guidance.

Paragraph (b)(3) of the waiver guidance contemplates that a commercial hedger holding the physically-settled Referenced Contract as a BFH would take that contract to physical delivery.[22] If the

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[21] Because cash-settled contracts do not go to delivery and settle at or prior to expiry of physically-settled Referenced Contracts, if the Five Day Rule were applied to physically-settled Referenced Contracts in markets for energy commodities under federal or exchange-set position limits, it would leave commercial energy firms fully exposed to price risk prior to actual physical delivery.

[22] In relevant part, paragraph (b)(3) of the proposed waiver guidance states:

> Any such designated contract market or swap execution facility may waive any such restriction, including if:
>
> . . . .
>
> (3) The person wishing to exceed federal position limits during the spot period:
>
> (A) Intends to make or take delivery during that time period;
>
> (B) Provides materials to the designated contract market or swap execution facility supporting a classification of the position as a bona fide hedging transaction or position and demonstrating facts and circumstances that would warrant holding such position in excess of limits during the spot period;
>
> (C) Demonstrates cash-market exposure in hand that is verified by the designated contract market or swap execution facility and that supports holding the position during the spot period;
>
> (D) Demonstrates that, for short positions, the delivery is feasible, meaning that the person has the ability to deliver against the short position (i.e., has inventory on hand in a deliverable location and in a condition in which the commodity can be used upon delivery); and
>
> (E) Demonstrates that, for long positions, the delivery is feasible, meaning that the person has the ability to take delivery at levels that are economically appropriate (i.e., the delivery comports with the person's demonstrated need for the commodity and the contract is the cheapest source for that commodity).

Suncor Energy Marketing Inc.
P.O. Box 2844
150 – 6th Avenue S.W.
Calgary, AB T2P 3E3
Tel 403-296-8000
Fax 403-296-3030
www.suncor.com

Exchanges were expected to apply the waiver guidance to every hedge exemption involving a physically-settled Referenced Contract to which the Five Day Rule would not apply, it would harm legitimate commercial hedging activity in energy markets. Specifically, the waiver guidance would prohibit SEMI and a large number of commercial energy firms from holding a physically-settled Referenced Contract as a BFH in the spot month for purposes of engaging in, among other things, (i) cross-commodity hedges in crude or product markets discussed in Section II.B.1.c, above, (ii) storage hedges in crude and natural gas markets, (iii) CMA price hedges, as well as harm their ability to enter into (a) EFP transactions or (b) alternative delivery procedures which generally are used when counterparties prefer not to perform under the exact terms of a futures contract, and (iv) hedges of unfilled anticipated requirements for refining and other purposes.[23]

Accordingly, any final rule adopted in this proceeding should expressly clarify that the waiver guidance set forth in Appendix B, paragraph (b) would only apply (and must only be followed) in circumstances in which an Exchange affirmatively identifies a physically-settled Referenced Contract as being subject to the Five Day Rule and waiver is expressly requested by a commercial hedger. Stated another way, if the Exchange does not expressly designate a Referenced Contract as being subject to the Five Day Rule, the Appendix B waiver guidance would not apply and need not be followed by the Exchanges. Such a clarification would not in any way preclude or otherwise restrict the Exchanges from utilizing other measures available to them to manage and ensure the fair, orderly, and efficient expiry of a spot month physically-settled Referenced Contract.

2. Referenced Contracts Subject to the Federal Position Limits.

SEMI has carefully reviewed, and continues to review, the *CFTC Staff Position Limits Work Book* ("**Workbook**")[24] in order to constructively comment on it. Through this process, SEMI has identified various issues and several questions regarding the scope and applicability of the proposed federal regime. Among other things, SEMI recommends that the Workbook should be restructured and include an introductory section or appendix that clearly explains the principles and rational used by Commission staff for determining which commodity derivative contracts are included in the Workbook and those that are not. Additional clarity and certainty are needed before the Workbook is adopted or otherwise formally recognized by the Commission as being an accurate and complete listing of exchange-listed Referenced Contracts subject to federal speculative position limits.

The need for regulatory certainty with respect to the scope and applicability of the proposed federal regime to Referenced Contracts is paramount. For commodity derivative contracts that are not listed in the Workbook, market participants will need to go through the subjective process of making individual determinations about whether such contracts are subject to federal position limits. Clarification and certainty provided by the Commission will help minimize the compliance burdens imposed on market participants by the Proposed Rule and help to mitigate differing interpretations across the industry about which contracts are "in" or "out" of the federal regime.

3 The Commission Should Limit the Extraterritorial Reach of the Proposed Regulatory Framework for Federal Position Limits to Referenced Contracts Listed for Trading on U.S.-Based Exchanges and Swaps Subject to CEA Section 2(i).

Pursuant to proposed CFTC Regulation 150.2(h), the proposed federal position limits regime will extend to Referenced Contracts, including positions executed on, or pursuant to the rules of a foreign board of trade ("**FBOT**") if (i) such Referenced Contracts settle against the price of one or more contracts listed for trading on an Exchange; and (ii) the FBOT makes such Referenced Contracts available to its

23 *See, e.g.,* NYMEX Rule 538; IFUS Rule 4.06; CME Rules 770-79.

24 PDF and Excel versions of the CFTC *Workbook* can be found at the following link: https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/PositionLimitsforDerivatives/index.htm.

Suncor Energy Marketing Inc.
P.O. Box 2844
150 – 6th Avenue S.W.
Calgary, AB T2P 3E3
Tel 403-296-8000
Fax 403-296-3030
www.suncor.com

members or other participants located in the U.S. through "direct access"[25] to its electronic trading and order matching system. Market participants will be required to aggregate FBOT-listed Referenced Contracts with other Referenced Contract positions in the same underlying commodity to determine compliance with federal positions limits.

Several contracts listed on ICE Futures Europe ("**IFEU**")[26] that are priced-linked to the enumerated energy CRFCs are listed in the Workbook. Notwithstanding IFEU's status as registered FBOT with the Commission, SEMI is concerned that the extension of the proposed federal position limits regime to Referenced Contracts listed for trading on IFEU could have unintended consequences, such as (i) requiring U.S.-based market participants to comply with potentially conflicting requirements of multiple regulators (*i.e.,* the CFTC and Financial Conduct Authority) and position limits regimes (*i.e.,* CEA and MiFID II), and (ii) incentivizing foreign regulators (*i.e.,* Financial Conduct Authority) to extend their reach into CFTC jurisdictional markets. Such conflicts would likely violate the principles of international comity recognized by the Commission.[27]

As noted in its recent Cross-Border NOPR, principles of international comity counsel the government in one country to act reasonably in exercising its jurisdiction with respect to activity that takes place in another country, as statutes should be construed to ''avoid unreasonable interference with the sovereign authority of other nations.''[28] When considering, among other things, the level of a foreign jurisdiction's supervisory interests over the subject activity and the extent to which the activity takes place within the foreign territory, the Commission has strived to minimize conflicts with the laws of other jurisdictions. In this respect, the Commission has traditionally sought to implement an approach based on substituted compliance intended to mitigate burdens associated with potentially conflicting foreign laws and regulations in light of the supervisory interests of foreign regulators in entities domiciled and operating in their own jurisdictions.

Accordingly, consistent with the principles of international comity and deference to competent regulators in foreign jurisdictions, the Commission should reconsider the potential regulatory conflicts and burdens that could be imposed on market participants who transact Referenced Contracts listed on IFEU and adopt a policy designed to minimize such conflicts through a policy of substituted compliance.

4. The Commission Should Allow for the Phase-In of Applications for Exemptions from Federal Speculative Position Limits.

To ease administrative burdens, and for the sake of consistency and uniformity in the review and processing of applications for BFH exemptions from federal speculative position limits, including Non-Enumerated BFHs pursuant to proposed Regulation 150.9, Exchanges should be granted authority to accept for review and grant such applications in advance of the compliance date established by any final rule issued in this proceeding. Permitting the Exchanges to accept BFH applications in advance of the compliance date will ensure that an orderly process is in place to process such applications and

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[25] "Direct access" means "an explicit grant of authority by [an FBOT] to an identified member or other participant located in the United States to enter trades directly into the trade matching system of the foreign board of trade." Proposed Rule at 11,634 n.238 (citing CFTC Regulation 48.2(c)).

[26] *See In the Matter of the Application of ICE Futures Europe for registration pursuant to Section 4(b)(1) of the Commodity Exchange Act and Part 48 of the Regulations of the Commodity Futures Trading Commission in order to permit direct access to its order entry and trade matching system*, Order of Registration, Commodity Futures Trading Commission (Oct. 31, 2016).

[27] *See* Notice of Proposed Rulemaking, *Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants*, 85 Fed. Reg. 952, 957-58 (Jan. 8, 2020) ("**Cross-Border NOPR**") (addressing the principles of international comity considered by the Commission in issuing a new proposed rulemaking addressing certain swap provisions of the CEA).

[28] Cross-Border NOPR at 957.

Suncor Energy Marketing Inc.
P.O. Box 2844
150 – 6th Avenue S.W.
Calgary, AB T2P 3E3
Tel 403-296-8000
Fax 403-296-3030
www.suncor.com

would prevent a "logjam" situation that stretches or overwhelms the Exchanges' own resources resulting from a submission of applications by a large number of market participants on or just before the compliance date.

III. CONCLUSION.

SEMI appreciates the opportunity to provide comments on the Proposed Rule and requests that the Commission consider the comments set forth herein. SEMI reserves the right to supplement these comments as deemed necessary and appropriate.

If you have any questions, or if we can be of further assistance, please contact the undersigned.

Respectfully submitted

/s/ Christopher Orr______

Christopher Orr
Morwenna Lane

On behalf of
Suncor Energy Marketing Inc.
Suncor Energy Inc.