



May 15, 2020

Via Electronic Submission

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

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

Dear Mr. Kirkpatrick:

I. INTRODUCTION

In response to the Commodity Futures Trading Commission’s (“CFTC” or “**Commission**”) Proposed Rule, *Position Limits for Derivatives* (“**Proposed Rule**”),¹ these comments are being submitted on behalf of the companies in the Shell Trading and Supply network that support Shell’s North American based oil products, natural gas, power and chemicals supply businesses by providing hedging and risk management services through the trading of derivatives for natural gas, electrical power, crude oil, refined products, chemical feedstocks and environmental products.² Shell has been an active participant in the comment processes for the Commission’s previous position limits proposals through various trade groups.³ Generally, the Proposed Rule offers an opportunity for the Commission to implement a regime of federal position limits in accordance with the requirements of the Dodd-Frank Wall Street Reform and

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

² The primary companies for this activity are Shell Trading (US) Company and Shell Energy North America (US), L.P., referenced herein as (“**Shell**”).

³ See Notice of Proposed Rulemaking, *Position Limits for Derivatives*, 76 Fed. Reg. 4,752 (Jan. 26, 2011); Notice of Proposed Rulemaking, *Position Limits for Derivatives*, 78 Fed. Reg. 75,680 (Dec. 12, 2013); Supplemental Notice of Proposed Rulemaking, *Position Limits for Derivatives: Certain Exemptions and Guidance*, 81 Fed. Reg. 38,458 (June 13, 2016); Reproposal, *Position Limits for Derivatives*, 81 Fed. Reg. 96,704 (Dec 30, 2016) (collectively, “**Prior Proposals**”)

Consumer Protection Act⁴ that meets the overall policy objectives of protecting derivatives markets from excessive speculation while accommodating the needs of commercial energy firms, like Shell, to hedge risks of their physical energy businesses. Both objectives are vital to the efficient operation of the energy sector and the overall economy.

Crafting a rule that strikes the right balance between protecting the interests of bona fide hedgers and preventing excessive speculation is the centerpiece of the rule. This is not an easy task, as demonstrated by the fact that this is the Commission’s fifth attempt to implement a rule since the passage of the Dodd-Frank Act almost ten years ago. In his statement supporting the Proposed Rule, Chairman Heath Tarbert highlighted the balancing act that must be accomplished when he said, “[p]osition limits is a rare rule where the exception is as important as the rule itself.”⁵ Even with the position limit levels proposed for energy products, Shell will use many of the hedging strategies that the Commission is proposing to adopt as enumerated hedges in Appendix A to Part 150 (“**Enumerated BFHs**”) to manage its portfolio of energy assets. Except for a few instances, which should require minor clarifications or changes, the list of Enumerated BFHs is a good start for the proposed position limits regime.⁶

It is not only important to identify the appropriate hedging practices for exemption purposes; it is also necessary to make sure that they work as intended for energy market participants. Shell supports the Commission’s proposals with respect to the treatment of hedges for pass-through swaps and the associated recordkeeping and reporting requirements.⁷ The Proposed Rule will allow the Commission to obtain access to information that is necessary to monitor market participants’ behavior while not imposing an undue burden on them. As discussed below, however, some clarifications to the Proposed Rule are required to remove ambiguities concerning the due diligence and recordkeeping obligations under proposed CFTC Regulation 150.3(d) and ensure that the pass-through swap proposal accommodates all market participants.

II. THE OVERALL APPROACH TO POSITION LIMITS IN THE PROPOSED RULE IS REASONABLE

The Commission has an obligation under Section 4a(a) of the Commodity Exchange Act to reduce excessive speculation, but it must do so in a manner that allows commercial energy firms to manage their exposure to price risks posed by energy markets. These exposures

⁴ Pub. L. No. 111-203, 124 Stat. 1376 (2010) (“**Dodd-Frank Act**”).

⁵ Proposed Rule at 11,731 (Appendix 2 - Supporting Statement of Chairman Heath Tarbert).

⁶ The Commission noted that it “...would be open to adopting additional enumerated hedges as it becomes more comfortable with evolving hedging practices, particularly in the energy space....” Proposed Rule at 11,601.

⁷ See Proposed CFTC Regulation 150.1 (defining “bona fide hedging transactions or positions”); Proposed CFTC Regulation 150.3(d) (providing proposed recordkeeping requirements).

manifest themselves in the energy markets in which Shell participates. The Proposed Rule is a substantial improvement from the Prior Proposals and includes several positive features. Without these features, the ability of Shell to provide energy to its customers in a cost-effective manner would be constrained by a position limits rule that is too prescriptive and narrow.

The key features of the Proposed Rule that will support Shell's efforts to manage its energy market price exposure are as follows:

- The proposed federal limits are set at reasonable levels given that they apply not only to Core Referenced Futures Contracts ("**CRFCs**") but also to futures and options on futures linked to a CRFC as well as Economically Equivalent Swaps;
- The proposed federal limits are based on updated deliverable supply estimates;⁸
- Eliminating from federal position limits for energy products the prohibition on the ability to hold a physically-settled Referenced Contract as a bona fide hedge during the last five days of trading ("**Five Day Rule**");
- The Commission's proposal to limit the application of the federal limits to the spot month for energy commodities recognizes the difference between the energy markets and other commodity markets such as the agriculture markets;
- The proposed list of Enumerated BFHs has been expanded from past position limit proposals to include exemptions that cover a larger set of hedging practices commonly used in the energy sector, such as anticipated merchandising and enumerated hedge exemptions that can be accomplished on a cross-commodity basis;
- The Proposed Rule includes an exemption from applicable federal position limits for certain enumerated spread transactions;
- The new fast-track approval processes proposed for non-enumerated hedges ("**Non Enumerated BFHs**") under proposed CFTC Regulation 150.9(e) establishes a framework that allows a market participant to obtain certainty about a hedging practice ten (10) business days after an Exchange's notification to the Commission of approval of an applicant's request. It also includes a two (2) day process for situations that arise due to sudden or unforeseen circumstances. This allows all participants associated with the process to leverage the expertise of the Exchanges and establishes a program that captures some of the realities of operating in these markets. Implemented properly, it offers a reasonable path for prompt

⁸ Proposed Rule at 11,625-26.

determination of Non Enumerated BFH requests while maintaining the Commission's obligation to oversee the application of federal position limits;⁹

- Including a bona fide hedge treatment for qualifying offsets of pass-through swap positions will reduce the potential for disruption to opportunities for firms to enter into swaps to hedge their energy positions and the costs associated with offering them;
- Eliminating the monthly reporting of cash-market positions under Form 204 and establishing a recordkeeping process that requires hedgers to track their positions to assure compliance is far more efficient and allows market participants to leverage the systems and processes they already use to track exchange-set position limits to meet the requirements under the Proposed Rule; and
- Giving market participants a 365 day compliance period after the publication of the final rule in the *Federal Register* should afford market participants sufficient time to prepare Non-Enumerated BFH applications for consideration and action by the Exchanges and the Commission, make adjustments to recordkeeping systems to account for the proposed requirements and train personnel on the rule.¹⁰

III. CERTAIN CLARIFICATIONS AND ADJUSTMENTS TO THE PROPOSED RULE ARE NECESSARY FOR SUCCESSFUL IMPLEMENTATION

The Proposed Rule requires some clarifications, or, in a few cases, minor changes to meet the objective of accommodating bona hedging practices. The concerns and recommendations discussed below will impact Shell's ability to serve customers in an efficient manner.

A. The Proposed Rule May Not Allow Firms with Certain Organizational Structures to Use the Pass-Through Swap Offset

Shell participates in energy markets through various affiliates but manages exposures centrally, especially with respect to position limits. Specifically, Shell uses an affiliate to execute transactions with exchanges so that it can manage portfolios and position limits on an aggregated basis. An overly strict interpretation of proposed CFTC Regulation 150.1 could mean that in this context the **pass-through swap counterparty** is the only entity that can utilize

⁹ Shell expects that Commission Staff would be actively involved with this process and notes that the proposed stay provision and ability to act on an application even after the 10-day period affords it flexibility to consider applications.

¹⁰ Shell would also support a "phased-in" approach so that the Exchanges have the opportunity to review and approve applications for Non Enumerated BFH exemptions prior to the compliance date of any final rule issued in this proceeding.

the pass-through exemption. In other words, in a situation where one affiliate (Affiliate A) goes to the futures or swap markets (as the firm in the corporate family that executes futures) to offset a swap that another affiliate (Affiliate B) did with an unaffiliated counterparty that qualifies as bona fide hedge transaction for that counterparty, a strict interpretation could mean that Affiliate B would not get the benefit of the passthrough swap offset exemption.

Shell assumes that the Commission would not apply a strict interpretation of the proposed pass-through swap offset rule given that compliance of position limits is on an aggregated basis.¹¹ A different interpretation would not only be contrary to aggregation rules but unnecessarily disrupt corporate structures for firms that manage their overall energy market exposures on an enterprise-wide basis in order to use this exemption.

B. The Proposed Pass-Through Swap Counterparty Exemption Should Be Changed to Allow for Cross-Commodity Hedges

The proposed pass-through swap offset exemption contains another ambiguity that Shell does not believe was intended by the Commission. Proposed CFTC Regulation 150.1(i)(B) says that the “pass-through swap offset” must be a swap or futures in the “**same physical commodity**.” It appears that this language would eliminate the ability to utilize the pass-through swap offset exemption when the offset itself is a cross-commodity hedge of the underlying pass-through swap.

For example, if Shell does a power swap with a counterparty and uses natural gas futures to offset the pass-through swap transaction, it would appear that the natural gas futures would be subject to federal position limits and not get the benefit of the pass-through swap offset exemption. In the same vein, if Shell desired to offset a heating oil, ULSD/gasoil/ jet fuel, or gasoline blendstock swap that qualified for the pass-through exemption on a cross-commodity basis using NYMEX RB or HO futures, as appropriate, it appears that the related pass-through swap offset would not be exempt from applicable federal position limits.

There is no explanation in the preamble or text of the Proposed Rule that the pass-through swap offset should not be allowed on a cross-commodity basis. Shell recommends that the Commission revise the text in proposed CFTC Regulation 150.1(i)(B) to delete the language that would restrict the offset of futures in the “same physical commodity.” In this respect, the proposed Regulation 150.1(i)(B) should be modified to read:

The pass-through swap offset is a futures, option on a futures, or swap position entered into by the pass-through swap counterparty ~~in the same commodity as the pass-through swap,~~ and which reduces the pass-through swap counterparty’s price risk attendant to that pass-through swap....”

¹¹ 17 C.F.R. § 150.4 (2020)

C. The Recordkeeping Requirement for Pass-through Swaps Is Ambiguous

The preamble text of the Proposed Rule discusses the due diligence requirements for pass-through swaps and associated recordkeeping requirements.¹² It suggests that the pass-through swap counterparty could meet this diligence requirement by, among other things, relying on a representation given by the hedging counterparty that the pass-through swap itself meets the requirements of a bona fide hedge. Specifically, it states that:

Proposed § 150.3(d)(2) addresses recordkeeping requirements related to the pass-through swap provision in the proposed definition of bona fide hedging transaction or position in proposed § 150.1. Under proposed § 150.3(d)(2), a pass-through swap counterparty, as contemplated by proposed § 150.1, would be required to: (i) maintain any written representation for at least two years following the expiration of the swap; and (ii) furnish the representation to the Commission upon request.

Under proposed CFTC Regulation 150.3(d)(2), the pass-through swap counterparty would be subject to certain recordkeeping requirements which would apply, in relevant part, to:

. . .all relevant books and records supporting such a representation, including any record the person intends to use to demonstrate that the pass-through swap is a bona-fide hedging transaction or position, for at least two years following the expiration of the swap.¹³

Although the preamble text states that the pass-through swap counterparty may meet its compliance obligation by keeping the representations it obtains from its hedging counterparties as appropriate records under proposed Regulation 150.3(d), the actual regulatory text appears to contemplate more by referencing books and records showing a bona fide hedge transaction.

In light of this internal inconsistency, Shell requests that the Commission clarify that the pass-through swap counterparty can rely on the hedging counterparty's good faith representation that a record of an agreement or confirmation of the transaction containing the bona fide hedge pass-through representation would satisfy the record retention requirements set forth in proposed Regulation 150.3(d)(2).

In addition, Shell is concerned that obtaining and keeping records of swap transactions that are bona hedges for our counterparties on a swap-by-swap basis would be an extremely

¹² See Proposed Rule at 11,642.

¹³ See Proposed Rule at 11,722.

burdensome endeavor that increases operating costs and risks. A process that allows Shell to obtain a blanket representation from its swap counterparties would be far more practicable than having to maintain a swap-by-swap inventory.¹⁴ Shell requests that the Commission clarify that obtaining a blanket representation from a counterparty that all swap transactions are for bona fide hedging purposes and keeping a record of the representation is acceptable under the Proposed Rule. Further, the bona fide hedging counterparty must identify swaps that are for speculation purposes so that they can be removed from consideration for the pass-through swap offset.

It is possible that some counterparties will not want to make such a blanket representation. In that case, the Commission should clarify that a flexible approach to satisfying this requirement is permissible, but not required. For example, swap dealers, or non-dealers that offer swaps, could, based on the facts and circumstances concerning a relationship or transaction, hold a good faith belief that the counterparty is in fact engaged in bona fide hedging. Such a belief could arise based on an understanding of the counterparty's business activity via an ongoing relationship. Under the Proposed Rule, compliance would require retention of records to demonstrate this.

D. Common Industry Hedging Practices That Should Be Treated as Enumerated BFHs

In furtherance of the goal of ensuring that the suite of **Enumerated BFHs** covers the appropriate commercial activity, Shell requests that the Commission clarify that hedges of unpriced physical purchase or sale commitments and use of physical delivery reference contracts to hedge physical transactions using calendar month average pricing fall within the **Enumerated BFH** for Anticipated Merchandising.¹⁵ In addition, clarification with respect to the scope of the Enumerated BFH for Cross-Commodity Hedges to include hedges of Unfilled Anticipated Requirements and Anticipated Merchandising should be provided. The Proposed Rule should accommodate these hedges at least for firms in the energy sector.

It is also important for Shell to have the ability to manage exposures associated with the change in value of assets it deploys in the energy supply chain. Assets used for the transport and storage of energy are a critical part of the energy value chain. These include fuel storage tanks and pipeline assets as example where time spreads or location basis spreads are used to lock-in

¹⁴ Shell Trading Risk Management, LLC is the primary Shell affiliate that enters into swaps and is a registered Swap Dealer.

¹⁵ See Proposed Rule at 11,612 (discussing Request No. 3 and Request No. 7, Scenario 2). Request No. 3 and Request No. 7, Scenario 2 are from the following: 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), <http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/wgbfhpetition012012.pdf>.

the values of the assets. With respect to such energy infrastructure assets, the Commission should clarify that the use of the hedges of anticipated storage or other physical assets is the type of risk activity that falls within the Enumerated BFH for Anticipated Merchandising or include it as an Enumerated BFHs in Appendix A, paragraph (a) to proposed Part 150 of the CFTC Regulations.

The hedging practices identified above satisfy the definition of bona fide hedging contained in Section 4(a)(c)(2) of the Commodity Exchange Act and are commonly used by firms like Shell to manage energy market price exposures associated with different aspects of their businesses. If the Commission fails to recognize these, the Exchanges and Commission may get bogged down with a large volume of applications for Non-Enumerated BFH recognition which would be inconsistent with the goal of minimizing the need for such applications.

E. The Commission Should Clarify the Applicability of Enumerated BFH for Anticipated Merchandising

The Enumerated BFH for Anticipated Merchandising set forth in Appendix A, paragraph (a)(11) of the Proposed Rule is, on its face, limited to “merchants,” which is an undefined term. Shell is concerned that if this Enumerated BFH is adopted as proposed and strictly construed many commercial firms, including integrated energy companies, that have traditionally engaged in merchandising activity would not be permitted to utilize this Enumerated BFH. Such a result would be contrary to the Commission’s view that “...merchandisers play an important role in the physical supply chain.”¹⁶

The Commission should revise the text paragraph (a)(11) to ensure that, in addition to merchants, other commercial energy firms such as producers, processors, energy marketers, power generators, that engage in business of merchandising and have a demonstrated history of buying and selling the underlying commodity for their respective merchandising businesses are able to utilize this important Enumerated BFH.¹⁷ Requiring non-merchant, commercial firms genuinely engaged in the business, and who have a demonstrated history of merchandising to obtain a Non-Enumerated BFH for the same anticipated merchandising activity that would

¹⁶ See Proposed Rule at 11,611..

¹⁷ In this respect, Shell supports the following proposed revision to Appendix A, paragraph (a)(11)(B) of the Enumerated BFH for Anticipated Merchandising set forth in the comments filed by The Commercial Energy Working Group:

(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, or using the underlying commodity for its merchandising business.

otherwise be permissible under Appendix A, paragraph (a)(11) would have the unintended consequence of competitively disadvantaging such commercial firms. Shell does not believe that the Commission intended such a result.

IV. CONCLUSION

The Proposed Rule represents a significant step forward in the implementation of a position limits regime that protects against excessive speculation while accommodating most bona fide hedging practices of energy firms. Recent events in global energy markets serve to highlight the importance of the direction Commission is taking with respect to the Proposed Rule by emphasizing flexibility and efficiency. Shell urges the Commission to adopt the Proposed Rule with the recommendations contained in these comments so that it can successfully manage risks associated with price movements in energy markets without burdening the Commission's efforts to protect against excessive speculation.

Respectfully submitted,

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