



May 15, 2020

Via Electronic Submission

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

**RE: Position Limits for Derivatives
RIN 3038-AD99**

Dear Mr. Kirkpatrick:

I. INTRODUCTION

The Edison Electric Institute (“EEI”) and the Electric Power Supply Association (“EPSA”) (hereafter “Joint Associations”) appreciate the opportunity to comment on the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) Notice of Proposed Rulemaking on Position Limits for Derivatives (“Proposed Rule”).¹ The Joint Associations have been active participants in the Commission’s numerous rulemakings implementing the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”),² including all of the position limits proposed rules.³ The Joint Associations appreciate the Commission’s issuance of the Proposed Rule and opportunity to submit comments.

EEI is the association that represents all U.S. investor-owned electric companies. Our members provide electricity for about 220 million Americans and operate in all 50 states and the

¹ *Position Limits for Derivatives*, Notice of Proposed Rulemaking, 85 Fed. Reg. 11596 (February 27, 2020) (“Proposed Rule”).

² Pub. L. No. 111-203 (2010)

³ See Letter from EEI and EPSA to David Stawick, Sec’y, CFTC (Mar. 28, 2011) (on file with the CFTC); Letter from EEI to David Stawick, Sec’y, CFTC (Jan. 17, 2012) (on file with the CFTC); Letter from EEI, AGA, and EPSA to David Stawick, Sec’y, CFTC (Mar. 1, 2012) (on file with the CFTC); Letter from EEI and AGA to David Stawick, Sec’y, CFTC (Mar. 1, 2012) (on file with the CFTC); Letter from EEI to David Stawick, Sec’y, CFTC (June 29, 2012) (on file with the CFTC); Letter from EEI and EPSA to Melissa Jurgens, Sec’y, CFTC (Feb. 7, 2014) (on file with the CFTC); Letter from EEI to Melissa Jurgens, Sec’y, CFTC (Aug. 4, 2014) (on file with the CFTC); Letter from EEI to Christopher Kirkpatrick, Sec’y, CFTC (March 30, 2015) (on file with the CFTC); Letter from EPSA to Christopher Kirkpatrick, Sec’y, CFTC (March 30, 2015) (on file with the CFTC); Letter from EEI and EPSA to Christopher Kirkpatrick, Sec’y, CFTC (July 13, 2016)(on file with the CFTC); Letter from EEI to Christopher Kirkpatrick, Sec’y, CFTC (February 27, 2017)(on file with the CFTC).

District of Columbia. As a whole, the electric power industry supports more than 7 million jobs in communities across the United States. EEI's members are committed to providing affordable and reliable electricity to customers now and in the future.

EPSA is the national trade association representing competitive power suppliers in the US, including generators and marketers. EPSA members provide reliable and competitively priced electricity from environmentally responsible facilities using a diverse mix of fuels and technologies. EPSA seeks to bring the benefits of competition to all power customers.⁴

The Joint Associations members are not financial entities. Rather, they are physical commodity market participants that rely on futures and swaps to hedge and mitigate their commercial risk. Regulations that make effective risk management options more costly for end-users of derivatives, such as the Joint Associations' members, will likely result in higher and more volatile energy prices for residential, commercial, and industrial electricity customers. As such, the Joint Associations and their respective members have a direct and significant interest in the Commission's establishment of speculative position limits.

As discussed herein, the Proposed Rule contains a number of improvements suggested by Joint Associations in previous comments and as such, the Joint Associations support the proposal.

II. COMMENTS

The Commission issued proposed rules to establish position limits in 2011, 2013, and 2016. While, each of the previous proposals made incremental improvements, they all found that the Commission did not need to determine that speculative position limits were needed before imposing them; contained narrow and unworkable definitions of *bona fide* hedges; and imposed additional recordkeeping requirements among other issues. The current proposal remedies many of these issues. The Commission indicates that it is issuing a new proposal that is intended to “(1) recognize differences across commodities and contracts, including differences in commercial hedging and cash-market reporting practices; (2) focus on derivatives contracts that are critical to price discovery and distribution of the underlying commodity such that the burden of excessive speculation in the derivatives contract may have a particularly acute impact on interstate commerce for that commodity; and (3) reduce duplication and inefficiency by leveraging existing expertise and processes at DCMs.”⁵ The Joint Associations support these goals.

A. The Proposed Rule Appropriately Finds That the Commission Must Show That Speculative Position Limits are Necessary Before Imposing Them

Commodity Exchange Act (“CEA”) Section 4a(a)(2), as amended by the Dodd-Frank Act, the Commission has the authority to establish, “as appropriate,” limits on speculative positions in derivatives contracts that are “necessary to diminish, eliminate or prevent” the burden on interstate commerce caused by excessive speculation (*i.e.*, by commodity price

⁴ This pleading represents the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

⁵ Proposed Rule at 11597.

fluctuations that are sudden, unreasonable, or unwarranted).⁶ Thus, the CEA, as amended by the Dodd-Frank Act, authorizes the Commission to impose position limits only after the Commission has found that the limits are necessary to prevent excessive speculation that appears likely to harm markets, and then only after designing the limits to minimize their negative impacts on the derivative markets. These determinations of necessity and appropriateness are important to avoid imposing unwarranted costs on commercial parties and other exchange market participants, and to ensure that any limits imposed are well-founded on a fully developed factual record. As such in the Proposed Rule, the Commission appropriately finds that a showing of need is necessary before imposing speculative position limits. The Commission indicates that **the** “Commission interprets these amendments as, among other things, tasking the Commission with establishing such position limits as it finds are “necessary” for the purpose of “diminishing, eliminating, or preventing” “[e]xcessive speculation...causing sudden or unreasonable fluctuations or unwarranted changes in...price...”⁷

In the Proposed Rule, the Commission sets federal and spot month position limits for 25 core referenced contracts, futures or options directly or indirectly linked to the core referenced futures, contracts, and economically equivalent swaps. Footnote 247 states that: “In practice, the only physically-settled referenced contracts under this proposal would be the 25 core referenced futures contracts, none of which are listed on multiple DCMs, although there could potentially be physically-settled OTC swaps that would satisfy the “economically equivalent swap” definition and therefore would also qualify as referenced contracts.” It is unclear what physically settled OTC swaps are referred to by the Commission. As such, the Joint Associations request that consistent with the Commission’s finding that a showing of need is required prior to imposing speculative positions limits, there should be a specific showing of need prior to adding new commodities to the list of referenced contracts. This would be consistent with the CEA and help ensure that stakeholders have an opportunity to comment before additional position limits are imposed.

B. The Spot Month Limits Are Appropriate.

As indicated above, the Proposed Rule sets federal and spot month position limits for 25 core referenced contracts, futures and options directly or indirectly linked to the core-referenced futures, contracts, and economically equivalent swaps. The Proposed Rule indicates that the proposed spot month limits for the referenced contracts are “set at or below 25 percent of deliverable supply as estimated using recent data provided by the DCM listing the core referenced future and verified by the Commission.”⁸ The Commission accepted each of the exchanges proposed levels for the individual core referenced contracts.⁹ The referenced commodity contracts used by the Joint Associations members are oil, fuel and natural gas. The limits for these commodities were based on estimates from the CME group. The Joint Associations support the Commission adopting CME Group’s estimates of deliverable supply for these contracts as exchanges are in the best position to provide accurate and current information on the markets. The Joint Associations also continue to support the Commission’s proposal to exclude trade options from the definition of referenced contract so that they will not

⁶ CEA § 4a(a)(2).

⁷ *Id.*

⁸ *Id.* at 11599.

⁹ *Id.* at 11625. *See also* FN 198.

be subject to position limits.¹⁰ This will enable commercial end users to continue to use these physically settled contracts to manage supply risk.

The Proposed Rule's also includes an exemption for the conditional limit in natural gas. As proposed, the conditional limit would allow a company that does not hold a position in the physically delivered NYMEX Henry Hub futures contract to hold up to 10,000 cash-settled futures equivalent contracts per futures exchange, and up to 10,000 futures equivalent swaps that are referenced contracts.¹¹ Joint Associations supports the inclusion of this exemption and agrees with the Commission's proposal to remove the previously proposed daily reporting requirements to rely upon the conditional limit. Those reporting requirements would have been burdensome without any apparent regulatory benefit. While supportive of the proposal, Joint Associations request the following clarification to and requests the following clarifications to provide additional clarity and reduce regulatory uncertainty.

- The Commission should consider modifying the condition that a participant cannot trade any physical delivery contracts during the spot month in order to be eligible for the conditional limit. This requirement forces a participant to choose between exclusively trading cash-settled or physical delivery derivative contracts. Joint Associations understand that the Commission proposed the conditional limit due to concerns that a person may take an excessive position to manipulate the physical delivery NYMEX contract.¹² Although the Joint Associations understand the Commission's concern, the qualification exclusion on any physical contracts treats any such position as excessive and is an overly rigid solution that may unnecessarily restrict legitimate trading activity. The Commission should permit a person to hold limited amount of physical delivery NYMEX contracts and still qualify for the conditional limit.
- Our understanding is that the conditional limit exemption is independent of a hedge exemption. In order to provide regulatory certainty, the Commission should confirm that a participant may rely upon the conditional limit in the first instance but may also utilize a hedge exemption to exceed the conditional limit.

The Joint Associations also support the Commission's proposal to set federal limits outside of the spot month only for the nine-legacy agriculture commodities subject to position limits. As previously noted in EEI comments, there has not been a need shown in the markets to set federal limits outside the spot month for other referenced contracts

C. The New Definition of *Bona Fide* Hedging e Appropriately Recognizes Hedging Practices Used by Commercial End Users.

The Joint Associations' members are physical commodity market participants that rely on commodity derivative contracts primarily to hedge and mitigate their commercial risk. If the Commission adopts a definition of *bona fide* hedging that is too narrow or inflexible, it will make important hedging activities more difficult for commercial end users which, as a

¹⁰ *Id.* at 11640, FN 279.

¹¹ *Id.* at 11640.

¹² *Id.*

consequence, may increase the price and volatility of energy for residential, commercial, and industrial customers. As such, the Joint Associations appreciate that the Commission has developed a *bona fide* hedge definition that is not too narrow and that provides flexibility.

The Joint Associations support expanding the list of enumerated *bona fide* hedges for the core referenced contracts which include unsold anticipated production, offsetting unfixed price cash commodity sale and purchase, anticipatory services, cross commodity, inventory and cash commodity fixed price contracts, commodity fixed price sales contract, sales by agents, offsets of trade options, unfilled anticipatory requirements, and anticipated merchandising. The Joint Associations also appreciate the Commission explicitly permitting all forms of *bona fide* hedging on an enterprise-wide gross or net basis.¹³ As indicated in previous Joint Association comments, this list accurately captures the breadth of hedging activity in which commercial end-users engage.

Regarding unfilled anticipatory requirements, Joint Association seek clarification to help ensure that the Commission's interpretation includes important and common energy hedging activities by energy industry commercial end users. It is common practice in the energy industry to contract for a secure and reliable flow of natural gas or delivery of fuel oil annually or seasonally at unfixed prices to ensure the reliability of electric generators. Many natural gas and fuel oil suppliers do not offer forward sales at effective fixed prices to electric generators since these are typically sole-supplier arrangements, and the fuel consumption is unpredictable, and not flat or ratable across the days or hours of a month. Instead, these suppliers offer a secure supply at a market-reflective index price. To address market price risk, many electric utilities use derivative contracts to forward hedge the fuel price risk of their filled but index-priced anticipated requirements. However, the language current enumerated *bona fide* hedge of unfilled anticipated requirements is unclear as to whether it covers filled but unfixed-price anticipated requirements so common to many electric generators. While the language in the Proposed Rule is clear regarding the *bona fide* hedging status of derivative contracts used to purchase physical product at spot prices on a real time basis,¹⁴ it is not clear that if a physical index-based contract is used for security of supply then that does not negate the legitimate hedging nature of the derivative. Joint Association seek clarification, that consistent with the interpretation from the Department of Market Oversight, that unfixed price purchase commitments do not "fill" an anticipated requirement.¹⁵

Joint Associations also agree, consistent with the Commission's proposal to allow market participants to apply for the creation of new *bona fide* hedges, that it would be difficult to maintain a list that captures all hedging activity across commodity types, and any list would inherently fail to take into account future changes in industry practices and other development. As such, Joint Associations agree that in order to allow for flexibility this list should be contained in Appendix A to Part 50 and not in the body of the regulations.¹⁶

¹³ *Id.* at 11733

¹⁴ *Id.* at 11727.

¹⁵ <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/12-07.pdf>

¹⁶ Proposed Rule at 11607.

D. The Proposed Rule Appropriately Provide a Process for Recognizing New *Bona Fide* Hedges.

In addition to advocating that the Commission adopt a definition of *bona fide* hedging that is easily understandable and commercially practical, Joint Associations urged the Commission to integrate the exchanges' expertise and well-established flexibility toward a process that assures *bona fide* hedging with a limited burden on end-users including delegating authority to exchanges to grant additional exemptions for transactions or positions that do not fit within one of the enumerated hedges. Under the Proposed Rule, the Commission proposes to define bona fide hedges as those that represent a substitute for transactions or positions made at a later time in a physical marketing channel ("temporary substitute test"); (2) are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise ("economically appropriate test"); and, (3) arises from the potential change in value of actual or anticipated assets, liabilities, or services ("change in value requirement").¹⁷ The Commission also proposes to allow market participants to seek approval for an exemption to the federal position limits for bona fide hedges that are not listed in the enumerated list in Appendix A of part 150 by demonstrating that they meet the three elements above. The exemption may be requested either by (1) applying directly to the Commission (and also to the exchange) or (2) using a new process that allows requests to be made only to the exchanges. Joint Associations support this proposal as it leverages the expertise of the exchanges and provides a workable delegation process.

The Proposed Rule, delegates the initial authority for approving an application for a non-enumerated hedge to the exchange, where the exchange maintains Commission-approved standards for such applications; if an exchange authorizes a non-enumerated hedge for a market participant, it must notify the Commission of its determination. Upon notice of the exchange's authorization of such an application, the Commission will have a 10-day review period (or two days where sudden or unforeseen needs exist) during which it can object to such authorization. If the Commission does not object to the exchange determination within this time period, the request is deemed approved.

The Proposed Rule outlines what must be included in the market participant's application to an exchange for recognition of an exemption.¹⁸ While, the Proposed Rule does not dictate timelines for exchanges to review exemption applications that are submitted by market participants, it does provide that an exchange may adopt rules to allow a market participant to submit for approval a bona fide hedging application within five days after federal position limits are exceeded, if such market participant exceeds the limits due to sudden or unforeseen circumstances and can provide materials to demonstrate such circumstances.¹⁹ The Commission indicates that if the Commission reject the application then the applicant would not be subject to a position limits violation if the applicant brings its position into compliance within a commercially reasonable time.²⁰ Joint Associations appreciate the Commission allowing market participants to unwind their positions without penalty.

In previous comments, Joint Associations requested that the Commission allow exchanges to recognize bona fide hedges given their experience with the markets and with hedging practices and

¹⁷ *Id.* at 11600.

¹⁸ *Id.* at 11652

¹⁹ *Id.* at 11653.

²⁰ *Id.* at 11601.

believes that the foregoing represents a workable process. To promote regulatory certainty, Joint Associations request the following clarifications related to the delegation process:

- The Commission indicates that listing the enumerated hedges in Appendix A provides flexibility and allows for development of new practices. In light of this recognition, Joint Associations suggest that when the Commission determines that a common hedging practice should be an enumerated bona fide hedge or if the exchanges make this determination and it is approved by the Commission, then it be made public and added to Appendix A. This would provide regulatory certainty and equal treatment for all market participants.
- If the Commission or exchanges determine that a new enumerated *bona fide* hedge is needed, will have the exchanges be responsible for naming and describing the new enumerated *bona fide* hedge?
- Joint Associations would suggest that to provide regulatory certainty and equal treatment for all market participants that the creation of a new *bona fide* hedge be made public and that the *bona fide* hedge be added to Appendix A.
- There are some entities that are not participating or actively participating on an exchange. These entities may decide to request the granting of a non-enumerated *bona fide* hedge through the Commission rather than through the exchange. Additional clarification on the process and timeline for seeking Commission action would provide regulatory certainty for these entities.

D. Regulatory Requirements for Commercial End Users

Regardless of whether the transactions meet the definition of *bona fide* hedge, commercial end users have recordkeeping and reporting responsibilities under part 150. Joint Associations appreciate the Commission not imposing significant new recordkeeping and reporting obligations as a result of the delegation process. Joint Associations also support the Commission proposal to remove the reporting obligations associated with Form 204 and Parts I and II of Form 304. Instead of requiring these forms to be submitted, the Commission indicates that it will rely upon the cash positions report from the exchanges. Since this new system will place a greater focus on the data reported to exchanges, Joint Associations urge the Commission to allow flexibility to the exchanges as to how this data is reported to them. This will help ensure that the removal of the reporting requirement provides reporting relief and is not replaced with increased reporting burden to the exchanges.

In addition, Proposed Regulation 150.3 (d) creates some uncertainty by requiring end users to maintain “complete books and records.” The proposed regulation states:

(d) *Recordkeeping*. (1) Persons who avail themselves of exemptions or relief under this section shall keep and maintain complete books and records concerning all details of their related cash, forward, futures, options on futures, and swap positions and transactions, including anticipated requirements, production and royalties, contracts for services, cash commodity products and by-products, cross-commodity hedges, and records of bona fide hedging swap counterparties, and shall make such books and records available to the Commission upon request under paragraph (e) of this section.

Joint Associations seek clarification that the Commission is not imposing an additional recordkeeping on commercial end-users beyond the records that are kept in the normal course of business and are typical for the relevant industry. EEI understands this to be consistent with current recordkeeping requirements for Trade Options. Imposing new specific recordkeeping requirements for position limits compliance will inject regulatory uncertainty into what is required to be kept and necessitate the creation of new processes and systems which will increase the regulatory burden and expense.

III. CONCLUSION

For the foregoing reasons, Joint Associations respectfully support the direction of the Proposed Rule with the requested clarifications to help provide additional clarity and regulatory certainty.

Respectfully Submitted,

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