Natural Gas Supply Association

February 28, 2017

VIA ONLINE 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:

By this letter, the Natural Gas Supply Association ("NGSA") respectfully submits comments regarding the U.S. Commodity Futures Trading Commission's (the "CFTC's" or "Commission's") Reproposal, Position Limits for Derivatives, 81 Fed. Reg. 96704 (December 30, 2016) (the "Reproposal"). NGSA submitted comments on February 10, 2014, June 26, 2014, August 4, 2014, March 30, 2015, July 13, 2016, and November 1, 2016 in response to prior Commission proposed rules and requests for comments regarding position limits, and NGSA appreciates the Commission's continued consideration of industry and end user concerns regarding position limits.

NGSA encourages the use of natural gas within a balanced national energy policy and promotes the benefits of competitive markets, thus encouraging increased supply and the reliable and efficient delivery of natural gas to U.S. customers. Founded in 1965, NGSA is the only Washington, D.C.-based trade association that focuses on producer/marketer issues related to the downstream natural gas industry.

As producers and suppliers of natural gas, NGSA members would not invest in the growth of the physical natural gas markets if they did not believe the market exhibited three key principles of health—integrity, transparency, and efficiency. NGSA believes that its requested modifications to the reproposed position limits rule would further promote these principles and respectfully requests the Commission's consideration of these comments.

COMMENTS

In providing authorization for federal position limits under the Commodity Exchange Act, 7 U.S.C. §§ 1 *et seq.* (the "CEA"), Congress required that certain safeguards be observed in establishing position limits or imposing them on end users, to avoid discouraging legitimate hedging activities or interfering with the healthy function of physical commodity markets. Specifically, Congress provided that:

1) "No rule, regulation, or order issued under [the federal position limits provisions] shall apply to transactions or positions which are shown to be bona fide hedging transactions or positions"; and

2) In establishing any position limits, the Commission should, to the maximum extent practicable: (a) "ensure sufficient market liquidity for bona fide hedgers" and (b) "ensure that the price discovery function of the underlying market is not disrupted."[1]

To comply with these mandates, the Commission must ensure that any new position limits rule: (i) maintains the breadth and flexibility of the statutory definition of "bona fide hedging position"; (ii) ensures the practical usability of the bona fide hedge exemption, including the processes for obtaining recognition of exempt positions and the associated reporting requirements; (iii) ensures that any new position limits are set at appropriate levels and without unnecessary additional restrictions; and (iv) provides adequate regulatory certainty with respect to each of the foregoing, for both exchange-traded and over-the-counter hedging transactions. NGSA believes that, so long as these criteria are met, natural gas markets should be able to function under a federal position limits regime.[2] The comments below discuss specific changes to the Commission's reproposed position limits rule that are necessary to satisfy these requirements in a manner compatible with actual commodity market structures and practices.

I. The Commission Must Maintain the Statutory Breadth and Flexibility of the "Bona Fide Hedging Position" Definition.

For the bona fide hedge exemption to fulfill its Congressional purpose of providing end users adequate opportunity to hedge their risks, it is essential that the Commission's regulatory definition of "bona fide hedging position" provide adequate breadth and flexibility and not introduce extra-statutory limitations on what constitutes a bona fide hedge. In this regard, NGSA supports the following adjustments that the Commission made to the definition and its related interpretive statements in the Reproposal:

---

[1] CEA § 4a(a)(3).

[2] NGSA does not take a position on whether such federal position limits are "necessary."

1) Explicitly recognizing in the definition that trade options adjusted on a futures-equivalent basis constitute cash commodity purchase or sales contracts (and that trade options are not themselves subject to position limits as "referenced contracts");[3]

2) Explicitly recognizing that anticipatory merchandizing and storage can serve as permissible subjects of non-enumerated bona fide hedging positions ("NEBFHs"), withdrawing the Commission's previous statements raising doubts about such possibility;[4] and

3) Eliminating the quantitative test for the suitability of cross-commodity hedges, and instead recognizing that such hedges should be evaluated on a facts and circumstances basis.[5]

Each of these changes eliminates extra-statutory requirements or restrictions that otherwise may have prevented end users in the natural gas and other industries from hedging common market risks consistent with the statutory criteria that Congress provided for exemption. However, the Reproposal still contains certain other extra-statutory requirements and restrictions that should be removed from the proposed regulatory definition to conform to the statutory mandate.

A. The "Economically Appropriate" Criterion within the Definition of "Bona Fide Hedging Position" Should Not Be Arbitrarily Limited to Price Risk, and Especially Not to Fixed-Price Risk.

To conform to the statutory mandate, the Commission should recognize that, consistent with the CEA, the bona fide hedge exemption can apply to a broad array of risks encountered by market participants—not just price risk, and particularly not just fixed-price risk. Section 4a(c)(2)(A)(ii) of the CEA provides the basic underlying statutory requirement, that bona fide hedging positions be "economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise." This standard is intentionally flexible, and the Commission should avoid adding non-statutory limitations to it.

However, in the Reproposal, the Commission reiterated its view that "the purpose of a bona fide hedging position must be to offset price risks incidental to a commercial enterprise's cash operation."[6] This imposes a standard that is narrower than that established by the statute, which provides only that bona fide hedging positions must be "economically appropriate to the reduction of risks in the conduct and

[3] Reproposal at proposed § 150.1.
[4] Reproposal at 96749.
[5] Reproposal at 96753.
[6] Reproposal at 96746.

management of a commercial enterprise." By doing so, the Commission would seemingly preclude, without even allowing for a fact-specific analysis, application of the exemption to numerous other types of risks that may be economically appropriate to hedge, including operational risk, liquidity risk, credit risk, locational risk and seasonal risk.[7] Accordingly, NGSA requests that the Commission clarify its guidance to recognize that "economically appropriate" hedges are not limited solely to hedges that address price risk.

In addition, NGSA requests that the Commission unambiguously recognize that an economically appropriate hedge of price risk can include hedges of index price risk,[8] not just fixed-price risk. Market participants can and often do encounter price risks associated with index transactions that they find economically appropriate to hedge. For this reason, ICE Futures U.S.'s ("ICE's") spot month exemption request form includes line items for underlying "unfixed-price" sales or purchases of cash commodities.[9] Although the Commission partially addressed one of the examples of non-fixed price risk described in joint comments filed by the NGSA in July 2016,[10] it did not plainly recognize the general concept that index priced transactions can be appropriate underlying purchase and sales contracts for bona fide hedging positions. Therefore, in addition to recognizing that "economically appropriate" hedges are not limited to hedges of price risk, NGSA requests that the Commission explicitly recognize that hedges of index price risk can qualify for the exemption.

B. The Commission Should Eliminate the Non-Statutory "Five-Day Rule" from the Reproposal's Definition of "Bona Fide Hedging Position."

The Commission should also eliminate the non-statutory "five-day rule" from its regulatory definition of "bona fide hedging position," which would otherwise apply to pass-through swap offsets, cross-commodity hedges, and anticipatory and other enumerated bona fide hedging positions ("EBFHs"). The relevant subsections of the definition provide that, as a condition of being recognized as bona fide hedging positions, such positions may not be maintained in any physical delivery commodity

---

[7] As an example, gas suppliers should be able to hedge the risk that new pipeline capacity will not be authorized and constructed in time to move gas from new production areas to market—because if transportation is not available, gas will have to be purchased in the delivery area to meet sales obligations.

[8] In natural gas markets, index price risk would include discount/premium changes and the spread between "first of the month" and daily indices.

[9] *See* ICE Energy Spot Month Exemption Request Form § 6.c, *available at* https://www.theice.com/publicdocs/otc/advisory_notices/IFUS_Energy_Position_Limit_Exemption_Form.doc.

[10] Comment Letter No. 60919 from NGSA and National Corn Growers Association ("NCGA") to Mr. Christopher Kirkpatrick, Secretary of the Commission (July 13, 2016). The Commission addressed one example of an index price risk hedge described by NGSA and NCGA by suggesting that it could be eligible for exemption as an EBFH for unsold anticipated production. *See* Reproposal at 96750.

derivative contract during "the lesser of the last five days of trading or the time period for the spot month in such physical-delivery contract" (referred to herein as the "expiry period"). This requirement would effectively force early liquidation of positions, which would both: (1) threaten to leave market participants exposed during the expiry period; and (2) risk distorting market efficiency (because the liquidation of these positions would be driven by an artificial regulatory requirement as opposed to market fundamentals). By contrast, allowing parties to maintain their hedge positions during the expiry period has the benefit of improving liquidity during such period. To the extent that the CFTC might be concerned about manipulation during the expiry period, the Commission should more appropriately address such concerns through its anti-manipulation authority, as opposed to completely withdrawing the bona fide hedge exemption during the expiry period.[11] For these reasons, the five-day rule should be removed from the definitional bona fide hedging position criteria.

Alternatively, to the extent that the Commission decides to rely on designated contract markets and swap execution facilities ("exchanges") in granting case-specific waivers of the five-day rule under the NEBFH process, the Commission should ensure that the reporting processes associated with positions held during the expiry period are not so onerous as to render use of such NEBFHs overly burdensome and impractical to use. In this regard, NGSA supports the approach Commission has taken to not require the exchanges to impose additional filing requirements with respect to NEBFHs under 150.9(a)(6) but instead to authorize them to require applicants to file reports "in the manner, form, and frequency as determined by the [exchange]."[12]

C. The Commission Should Broaden the Pass-Through Provisions in its Definition of "Bona Fide Hedging Position" to Allow the Exemption to Allow Additional Pass-Through Transactions Among Affiliates.

The Commission should broaden the pass-through provisions in its definition of "bona fide hedging position" to accommodate secondary pass-through transactions among affiliates within a corporate organization. This would serve the equitable purpose of allowing more market participants to make the most efficient and effective use of their existing corporate structures. As the Commission has recognized, some market participants that make outward-facing transactions with customers lay off the risk from such transactions through affiliates, including centralized derivatives-trading

[11] *See* Reproposal at 96840 (expressly recognizing that "a market participant's compliance with position limits or an exemption does not confer any type of safe harbor or good faith defense to a claim that he had engaged in an attempted manipulation, a perfected manipulation or deceptive conduct").

[12] Reproposal at 96823-24

or financing affiliates.[13] Corporate organizations making use of these structures should not be effectively prevented from making use of the pass-through exemption.

The Commission's response to this expressed concern in the Reproposal indicated that recognition of a "secondary" pass-through swap transaction among affiliates as a bona fide hedge should be unnecessary because the affiliates would be required to aggregate their positions under the Commission's aggregation rule, 17 C.F.R. § 150.4, which would net out the applicable pass-through swap and swap offset positions.[14] However, this ignores two situations. First, such affiliates may be exempt from aggregation under one of the several bases for exemption in § 150.4(b) of the aggregation rule. Where aggregation may allow one group of affiliates to net their pass-through swap and pass-through swap offset positions and "cancel them out" for purposes of the position limits rule, it would be inequitable to prohibit a different group of affiliates, that claims an exemption from aggregation (whether for practical reasons or to comply with separate legal requirements as provided under § 150.4(b)(7)), from making use of the bona fide hedge exemption for an identical set of transactions. The second situation where the positions would not simply "net out" under the aggregation rule is where the affiliate that ultimately takes the risk chooses to warehouse the risk and not lay it off in the market. Here, too, there is no reason not to allow that affiliate to get the benefit of the pass-through. The availability of the pass-through to affiliates should be based on the purpose of the original transaction. If it was a bona fide hedge, then all offset transactions within a corporate family should get the benefit of the pass-through exemption.

Therefore, NGSA reiterates its request that the Commission accommodate market participants with multi-entity corporate structures by making the following changes to Section 2(ii) of the definition of "bona fide hedging position":

> (ii)(A) *Pass-through swap offsets.* Such position reduces risks attendant to a position resulting from a swap in the same physical commodity that was executed opposite a counterparty for which the swap would qualify as a bona fide hedging position pursuant to paragraph (2)(i) of this definition (a pass-through swap counterparty), provided that the bona fides of the pass-through swap counterparty may be determined at the time of the transaction, and any pass-through swap offset that is a bona fide hedging position for a person under this paragraph (2)(ii)(A) (a primary offset counterparty) shall also be a bona fide hedging position for a person (a secondary offset counterparty) that controls, is controlled by, or is under common control with such primary offset counterparty with

[13] CFTC No-Action Letter No. 14-144 (Nov. 26, 2014), No-Action Relief from the Clearing Requirement for Swaps Entered into by Eligible Treasury Affiliates.

[14] Reproposal at 96751.

respect to a swap between such primary offset counterparty and secondary offset counterparty that is commercially identical to, and entered into as of the same day as, the swap between the primary offset counterparty and the pass-through swap counterparty;

(B) *Pass-through swaps.* Such swap position was executed opposite a pass-through swap counterparty and to the extent such swap position has been offset pursuant to paragraph (2)(ii)(A) of this definition; or

(C) *Offsets of bona fide hedging swap positions.* Such position reduces risks attendant to a position resulting from a swap that meets the requirements of paragraph (2)(i) of this definition.

Making these changes to the pass-through hedge exemption provisions will provide equitable and efficient access to the exemption, which will benefit both large and small market participants by increasing hedging efficiency and facilitating market liquidity.

II. The Commission Must Ensure the Practical Usability of the Processes for Exchange Recognition of NEBFHs.

In addition to providing a proper definition of "bona fide hedging position," the Commission must ensure that the exemption is practically usable by market participants and provides adequate flexibility to accommodate a wide and evolving array of economically appropriate hedging activity. In this regard, it is helpful to provide a broad list of enumerated hedges that identify common bona fide hedging positions. Therefore, NGSA supports the Commission's openness to expanding the current list of EBFHs, which can increase market efficiency by reducing regulatory uncertainty and the burdens and costs of making applications for hedge recognition to the exchanges.

However, as the Commission has recognized, it is simply impossible to enumerate every acceptable bona fide hedging activity.[15] Therefore, NGSA also supports the Commission's provision for a process whereby market participants can apply to the exchanges for recognition of hedging positions that satisfy the CEA's definition of a bona fide hedging position but do not fall within any of the Commission's enumerated categories, *i.e.*, NEBFHs. As the Commission recognizes, the exchanges have well-developed practices and substantial expertise with respect to administration of such exemptions and are well-placed to determine which activities qualify for bona fide hedging position exemptions based on the applicable facts and circumstances.[16] NGSA members themselves have substantial experience using the exemption processes currently administered by ICE and CME and believe that they

[15] Reproposal at 96751.
[16] Reproposal at 96847-48.

work well—accommodating market participants' needs for flexibility, expediency, and predictability, all while consistently maintaining the integrity of the speculative position limits.

Accordingly, NGSA supports the following adjustments made in the Reproposal, which more closely align the Commission's requirements and guidance to the exchanges' proven practices, provide important safeguards, and eliminate unnecessary and duplicative requirements:

1) Requiring applicants to provide only one year of data in support of their applications for recognition of NEBFHs, as opposed to three;[17]

2) Explicitly recognizing that, if the Commission determines that an exchange's recognition of a bona fide hedging position was inconsistent with the CEA or the regulatory definition of a bona fide hedging position, the applicant should be granted a "commercially reasonable amount of time" to liquidate the derivative position or otherwise come into compliance—not proposing a fixed time period but instead acknowledging the need to "consider the facts and circumstances of each situation";[18]

3) Providing flexibility for exchanges to prescribe reporting requirements for NEBFHs "in the manner, form, and frequency as determined by the [exchange]."[19] (Importantly, this should allow exchanges to, as appropriate, implement reporting requirements that mirror those under Part 19 of the Commission's rules, allowing for streamlined compliance and avoiding unnecessary and inconsistent requirements); and

4) Streamlining the reporting requirements for exchange-recognized anticipatory bona fide hedges so that they follow, and do not duplicate or add to, the generally applicable reporting requirements for anticipatory hedges under proposed rule 150.7(e).[20]

However, the following three adjustments or clarifications should be made to the rule to ensure the NEBFH exemption processes are practically usable by end users engaging in hedging activities that satisfy the statutory criteria that Congress provided for the bona fide hedge exemption.

---

[17] Reproposal at 96822.
[18] Reproposal at 96827 and proposed § 150.9(d)(4).
[19] Reproposal at 96823-24 and proposed § 150.9(a)(6).
[20] Reproposal at 96839 and proposed § 150.11(a)(5).

A. The Exchanges' NEBFH Recordkeeping and Reporting Rules Must Be Flexible Enough to Accommodate Portfolio Hedging by Market Participants.

First, the Commission should clarify that the exchange recordkeeping and reporting requirements for NEBFHs should not require matching applicants' hedge positions to their underlying cash positions on a one-to-basis but should instead allow for recordkeeping and reporting of positions on an aggregate basis—to accommodate the practical needs of many market participants to hedge their risks on a portfolio basis. It is common practice in the natural gas and many other industries to maintain hedge positions against a portfolio of physical assets and related positions, as opposed to holding hedge positions that are neatly correlated to individual physical transactions. The market participant placing a hedge in this manner constantly reevaluates the hedge in light of multiple shifting factors in order to optimize the value and minimize the risk associated with its overall portfolio. The Commission has recognized the importance of such portfolio-hedging practices in industry and has provided for it in the Part 19 reporting rules that apply to market participants.[21] However, to avoid indirectly re-imposing a one-to-one matching requirement on applicants, the Commission should provide similar clarification in any final position limits rule that the exchange reporting and recordkeeping requirements under reproposed rules 150.9(b) and (c), including the summary reporting requirements in 150.9(c)(1)(K), should also apply to trading positions on an aggregate basis, thus allowing for portfolio hedging.

B. The Exchange NEBFH Recognition Rules Should Allow for Retroactive Recognition of NEBFHs Under Certain Limited Circumstances.

Second, the reproposed position limits rule should be modified to allow exchanges to recognize, under certain limited circumstances, NEBFH exemptions for up to a five-day retroactive period. As written, reproposed § 150.9(a)(4)(i) would require that, without exception, an applicant receive exchange recognition of a NEBFH *in advance* of the date that its position would otherwise be in excess of a position limit. However, market participants operating in dynamic markets with large trading books and complex positions can, on occasion, find themselves in circumstances where they have a sudden and unforeseen need to take an immediate hedge position that is, in fact, a bona fide hedge, but for which there is not enough time for advance application and approval. In particular, this situation may be likely to arise from time to time among affiliates that are required to aggregate their positions but whose operations are independent enough to result in some finite time lag in recognizing their aggregate level of trading exposures and hedging needs. The Commission's position limits rule should not prevent end users from hedging at such potentially critical moments, particularly when the exchanges have already developed and demonstrated processes

---

[21] *See* Reproposal at 96803, 96806 (discussing Form 204 reporting requirements).

that allow for such emergency hedge positions on a limited basis and in a manner that safeguards against potential abuse.

Accordingly, NGSA would support a rule allowing for retroactive recognition of NEBFHs by exchanges subject to two primary safeguards:

1) That the applicant be required to demonstrate that the applied-for hedge was required to address a sudden and unforeseen hedging need; and

2) That if the application is rejected, the applicant (a) be required to unwind its position as soon as commercially practicable and (b) be deemed to have been in violation for any period in which its position exceeded the applicable limits as a result.

Taken together, these requirements strongly discourage using the emergency hedge recognition mechanism to do anything other than meet truly critical hedging needs on a very infrequent basis. ICE and CME already impose these safeguards on applications for retroactive recognition of bona fide hedging positions with respect to exchange-level position limits,[22] and these exchanges' processes have proven to work well in allowing use of these important hedges in an infrequent and disciplined manner.

Finally, it is important to note that the requested retroactive application mechanism would not expand, in any way, what is properly a "bona fide hedging position" for purposes of the Congressional standard. Rather, it would merely adapt the process for recognition of a bona fide hedging position to better accommodate the realities of complex dynamic markets. For these reasons, NGSA urges the Commission to allow exchanges to recognize a bona fide hedging position (and allow an exemption) for up to a five-day retroactive period in circumstances where market participants exceed the speculative limits to address a sudden and unforeseen, but legitimate, hedging need.

C. The Commission Should Eliminate the NEBFH Requirement that an Exchange Post Quarterly Summaries of Each New Type of Derivatives Position that it Recognizes as a NEBFH.

Third, NGSA requests that the Commission eliminate the provision in the reproposed rule requiring an exchange to post, no less frequently than quarterly, a description of each new type of derivatives position that it recognizes as a NEBFH. NGSA appreciates the Commission's clarification that any data published pursuant to proposed rule 150.9(a)(7) should not disclose the identity of, or confidential information about, the applicant but, rather, should describe only generic facts and circumstances

[22] *See* CME Rule 559, available at http://www.cmegroup.com/rulebook/CME/I/5/5.pdf; ICE Rule 6.13(c), available at https://www.theice.com/publicdocs/rulebooks/futures_us/6_Regulatory.pdf.

and not include detail that would disclose any trade secrets or intellectual property.[23] However, NGSA questions how effectively this can be done and whether there the proposed publications would provide any significant benefit. NGSA believes that, at least in the natural gas markets, such summaries, even if kept generic, would in many cases be likely to effectively disclose the identity of the market participant as well as its confidential hedging strategies. At the same time, it is questionable whether market participants would gain any significant benefits from the summaries that would outweigh such risks.

Therefore, NGSA requests that the Commission eliminate the section 150.9(a)(7) quarterly publication requirement. At the very least, if the Commission retains such requirement, it should clarify that if the exchange reasonably determines that a summary cannot be published without a substantial likelihood of disclosing the identity of the hedging entity or its confidential hedging strategy, then the exchange shall not publish such summary.

III. The Commission Must Ensure That Any New Speculative Position Limits on Physical Commodities Are Set at Appropriate Levels and Without Unnecessary Additional Restrictions.

In addition, the Commission must ensure that any new federal speculative position limits are set at appropriate levels and are not so restrictive as to harm liquidity or price discovery in the applicable markets. Congress provided for the bona fide hedge exemption in the CEA because it recognized the importance of preserving broad opportunities for end users to hedge their commercial risks using derivatives. In order to ensure that such opportunities exist, it is essential that position limits not be set too low. Simply put, position limits, while preventing excessive speculation, must still leave significant room for some traders to enter into speculative or other non-bona fide hedge positions to ensure adequate liquidity for hedgers, since it is unrealistic to think that long hedge positions in any derivatives market will perfectly and efficiently match the short hedge positions. Therefore, it is important that position limits not be set too low or encumbered with unnecessary restrictions.

A. The Commission Should Increase the Spot Month Limit for the NYMEX Natural Gas (NG) Contract By Recognizing the Effective Transportation Capacity Available at Henry Hub Provided by Displacement.

To optimize liquidity in the NG Contract and harmonize the spot month limit to the characteristics of the U.S. natural gas market and practical needs of market participants, the Commission should increase the spot month limit on the NG Contract by recognizing the additional transportation capacity available at Henry Hub provided

[23] Reproposal at 96824.

by displacement. As the Commission has recognized, estimates of deliverable supply must "take into consideration the individual characteristics of the underlying commodity's supply and the specific delivery features of the [applicable] contract."[24] In this regard, the Commission's acceptance of CME's initial estimate of deliverable gas supply at Henry Hub[25] is appropriate because CME's basic methodology is generally tailored to the unique characteristics and features of the natural gas market at Henry Hub—in particular, being directly based on the actual physical transportation capacity of the pipeline system at Henry Hub.[26] However, the proposed spot month limit on the NG Contract is too low relative to the size of the Henry Hub market and realistic hedging needs of market participants, who need large trading partners in the NG Contract to ensure robust liquidity.

The proposed 2,000-contract spot month limit on the NG Contract is simply too low. Henry Hub is a highly interconnected natural gas distribution hub linking nine interstate and four intrastate pipelines, and the NG Contract, which settles based on physical delivery at Henry Hub, is the primary benchmark and hedging instrument for the U.S. natural gas market. Therefore, it is essential that end users have access to a robust market in the NG Contract with counterparties having substantial trading capacity. However, under the proposed 2,000-contract spot month limit on the NG Contract, a market participant could only be assured of its ability to hedge the fuel requirements of about 2,700 MW of natural gas-fired power generation capacity. This represents less than one percent of the currently-installed natural gas-fired electricity generating capacity in the United States,[27] and such gas-fired generation itself represents only about one-third of total U.S. natural gas consumption.[28] This relative level of the spot month limit is unduly restrictive with respect to the size of the Henry Hub market and effective capacity of the pipeline system.

Therefore, the spot month limit on the NG Contract should be increased by recognizing the additional supply available at Henry Hub provided by displacement. As explained in CME's April 15, 2016 comment letter to the Commission:

---

[24] Proposed Rule, Position Limits for Derivatives, 78 Fed. Reg. 75680 (Dec. 12, 2013) (the "2013 Proposed Rule") at 75729; *see also* Reproposal at 96719.

[25] Reproposal at 96754.

[26] For now and the foreseeable future, the sources of natural gas production and storage readily deliverable to Henry Hub substantially exceed the transportation capacity at the Hub, such that the estimate of deliverable supply is effectively constrained only by the transportation capacity.

[27] As of November 2014, the U.S. had just under 430,000 MW of installed natural gas-fired generating capacity according to the Department of Energy – Energy Information Administration ("EIA") December 2014 Electric Power Monthly report.

[28] *See* EIA Natural Gas Consumption by End Use, *available at* https://www.eia.gov/dnav/ng/ng_cons_sum_dcu_nus_a.htm.

> Displacement refers to the common practice of accommodating the scheduling and transportation of natural gas in opposite directions at pipeline interconnection points. Where such bi-directional flows or system nominations are common, displacement increases the effective flow capacity. The use of displacement is standard practice at Henry Hub.[29]

Regarding displacement, also referred to as "backhaul," the Federal Energy Regulatory Commission ("FERC") has, in its rulemakings, deliberately allowed shippers to make use of backhaul as a method of system delivery—to the same delivery point to which they are making forward haul from the opposing direction and up to a level equal to their maximum capacity for forward haul. FERC has recognized that this common market practice of allowing for backhaul makes efficient use of capacity—creating additional supply alternatives for shippers and enhancing competition on the pipeline system.[30] Accordingly, CME, which is well-placed to understand the effect of displacement capacity on deliverable supply for purposes of the NG Contract, has incorporated displacement into its estimate of deliverable supply at Henry Hub for years. Further, CME has confirmed the reasonableness and appropriateness of its methodology for such incorporation of displacement with the pipeline operator at Henry Hub.[31]

Thus, in order to better align the spot month position limit on the NG Contract to the actual deliverable supply of natural gas available at Henry Hub for contract fulfillment purposes, the Commission's estimates of deliverable supply at Henry Hub should recognize full capability of system, which includes bi-directional flow and displacement capacity. In its most recently submitted comments regarding deliverable supply, CME stated that it was withholding displacement capacity from its estimate for the NG Contract, pending further discussions with the CFTC, but indicated that incorporating displacement capacity may be appropriate in future estimates. NGSA urges the Commission to consider including such displacement in future estimates of deliverable supply for the NG Contract, to better fit the spot month position limit to the operational realities of the Henry Hub market.

---

[29] Comment Letter No. 60785 from CME Group to Mr. Christopher Kirkpatrick, Secretary of the Commission 5 n. 5 (Apr. 15, 2016).

[30] 101 FERC ¶ 61, 127 at P 54 (Oct. 31, 2002).

[31] Comment Letter No. 60435 from CME Group to Mr. Christopher Kirkpatrick, Secretary of the Commission 6 (Apr. 24, 2015).

B. The Commission Should Remove the Restriction that Makes the Higher Spot Month Limit on the Cash-Settled NG Contract Available Only to Market Participants With No Position in the Physical Delivery NG Contract.

NGSA supports the Reproposal's continued provision for a position limit on the cash-settled spot month NG Contract that is effectively five times higher than the limit on the physically-settled spot month contract. However, use of the higher position limit should not be conditioned on complete divestiture of physically-settled natural gas futures. A regulatory requirement forcing such divestiture would harm liquidity in the physically-settled spot month contract and essentially drive involuntary transactions, potentially harming the price discovery function with respect to the NG Contract.

The Commission recognized in the 2013 Proposed Rule that the physical divestiture condition raises a significant risk of harming liquidity in physically settled spot month contracts.[32] As the Commission has observed, open interest in such physically-settled contracts already typically declines markedly in the period immediately preceding the spot month.[33] Even without the physical divestiture condition, significant migration out of physically-settled spot month contracts will likely still take place due to the difference between the single month limit and the spot month limit and conditional limits that may be imposed by exchanges. However, the federal limit should not be structured to make things worse by requiring *complete divestiture* of all physically-settled spot month contracts.

The physical divestiture condition is even more problematic when considered in conjunction with the Commission's aggregation rule. Affiliates within a corporate group, which may be numerous and which may operate independently, can have compelling commercial reasons to differently utilize cash-settled versus physically-delivered contracts. Such affiliates should not be forced to depart from the hedging practices that best fit their commercial needs to satisfy an unnecessary condition.

Therefore, the Commission should eliminate the condition and rely on other mechanisms to address the underlying concern. The Commission's stated concern in the Reproposal was "reduc[ing] the risk that traders with large positions in cash-settled contracts would attempt to distort the physical delivery price to benefit such positions."[34] Simply put, the Commission should use more tailored measures to address the risks of such manipulative and disruptive trading practices. Congress has expressly provided authority to the Commission under the CEA to prevent such distortion by directly policing manipulative and disruptive trading practices.[35] By

---

[32] *See* 2013 Proposed Rule at 75738.

[33] *See* 2013 Proposed Rule at 75737.

[34] Reproposal at 96861

[35] *See* CEA §§ 4c, 6(c).

addressing manipulation concerns through such direct means, the Commission can eliminate the physical divestiture condition and avoid causing needless harm to liquidity in the physically-delivered spot month contract.

CONCLUSION

The changes and clarifications to the reproposed position limits rule discussed in these comments would conform the rule to the CEA's requirements while providing a workable position limits regime that is compatible with existing commodity market structures and practices. Nonetheless, NGSA has significant concerns regarding application of federal position limits and exchange administration of hedge exemptions to over-the-counter ("OTC") swaps. Preserving the ability of end users to enter into hedges using OTC swaps was a central priority of Congress in providing the end-user exception in the Dodd-Frank Act. However, there does not appear to be any mechanism for obtaining NEBFH exemptions for OTC positions—an issue that does not appear to have been addressed in the position limits rulemakings to date. This will create substantial regulatory uncertainty and a large gap in the availability of a workable bona fide hedge exemption for end users, potentially exacerbated by application of the aggregation rule across OTC positions. The Commission should consider an efficient means, whether through the NEBFH application rules to be submitted by the exchanges or otherwise, to ensure that this issue is appropriately addressed before attempting to apply the federal position limits to OTC swaps.

NGSA welcomes the opportunity to further discuss these comments with the Commission. If we can provide any additional information, please do not hesitate to contact us.

Respectfully submitted,

Jennifer Fordham
Senior Vice President, Government Affairs
Natural Gas Supply Association
1620 Eye Street, NW, Suite 700
Washington, DC 20006
Direct: 202-326-9317
e-mail: jfordham@ngsa.org
Natural Gas Supply Association