



May 14, 2020

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”) Proposal, Position Limits for Derivatives, 85 Fed. Reg. 11596 (February 27, 2020) (the “Proposal”). NGSA submitted comments on February 10, 2014, June 26, 2014, August 4, 2014, March 30, 2015, July 13, 2016, November 1, 2016 and February 28, 2017 in response to prior Commission proposed rules and requests for comments regarding position limits. NGSA appreciates the Commission’s continued consideration of industry and end user concerns regarding position limits.

NGSA remains committed to the resolution of position limits rules. However, the unprecedented events and economic uncertainty of the last several months highlight the importance of caution. Economic recovery and resiliency depend on sound rules *and* also on well-functioning markets, innovation, affordable hedging and sustained market liquidity. As a result of the COVID 19 crisis, global energy markets are sustaining rapid and dramatic impacts including a 16-year low energy use in the U.S.¹ Global demand for oil and natural gas is collapsing while supply is increasing resulting in the recent and unprecedented -36.98 price for WTI Intermediate Crude at Cushing

¹ See U.S. Energy Consumption Falls to 16-Year Low, Oil Price.com, April 18, 2020 *available at* <https://oilprice.com/Energy/Energy-General/US-Energy-Consumption-Falls-To-16-Year-Low.html>

Oklahoma on April 20.² The resilient U.S. natural gas market remains relatively stable but is notably different from the U.S. natural gas market a decade ago.

For the last decade, the natural gas spot price averaged \$3.29/MMBtu, 40% lower than the average price of \$5.81/MMBtu for the decade prior. Interestingly, the U.S. natural gas market has nearly doubled in size and to accommodate increased natural gas use, the industrial sector is expected to invest more than \$130 billion between 2015 and 2023.³ This is in addition to the billions invested by the natural gas production, natural gas-fired electric power generation and LNG sectors. **The visible step-change in the U.S. natural gas market over the last two decades stems from an investment fueled technological breakthrough, robust and transparent energy markets, hedging transactions and counterparty diversity.**

Ingenuity, combined with a robust, liquid and transparent competitive market has yielded a hearty and expedient approach to trading physical natural gas supplies at a variety of market hubs across the U.S. and this market approach has become a benchmark around the world.

Looking forward, more than \$400 billion in new natural gas infrastructure investment is expected over the next 15 years.⁴ The point of this statistic is simple. Investments hinge on sound market signals, competing ideas, capital market efficiency and the affordable ability to hedge a variety of unique and ever-changing risks. The U.S. natural gas market is an economic bright spot with a proven ability to fuel environmentally sound recovery domestically and abroad.

Perhaps now more than ever, the determination to put a decade of position limits uncertainty to rest must be reconciled with the inescapable *uncertainty* that will come from layering new regulations on an already strained market. Despite the fact that the natural gas commodity market is well-functioning and mature, recovery from the COVID 19 crisis will challenge all our commodity markets in extraordinary ways. New regulations that inadvertently hamper a market participant's ability to effectively manage risk in an efficient and in some instances, innovative, way will undoubtedly limit recovery. The uncharted territory we find ourselves in today warrants caution in the new steps forward.

² See EIA Petroleum and Other Liquids Daily Spot Prices Report *available at* <https://www.eia.gov/dnav/pet/hist/RWTCD.htm>

³According to the NGSAs 2019-2020 Winter Outlook (the "NGSA Winter Outlook") *available at* https://www.ngsa.org/download/analysis_studies/FINAL-NGSA-EVA-2019-2020-Winter-Outlook.pdf the industrial sector invested \$50 billion in the 2015-2018 timeframe and another \$83 billion investment is expected from the sector between 2019 and 2023.

⁴North American Midstream Infrastructure through 2035 - Significant Development Continues, The INGAA Foundation, Inc., June 18, 2018 *available at* <https://www.ingaa.org/File.aspx?id=34658>.

In the core objectives of establishing the safeguards for end users to avoid discouraging legitimate hedging activities or interfering with the healthy function of physical commodity markets, the Proposal gets several important issues right. In addition to establishing a path that facilitates market participant certainty for exchange administration of both enumerated and non-enumerated hedges, the Proposal addresses several critical end user issues that have been elusive until now. Proposed changes that are vital to end users abound. Importantly, the Proposal –

1. Provides market participant bona fide hedging certainty and expands the list of enumerated hedges to include anticipated merchandising hedging as well as other specific enumerated hedges,
2. Expands the use of the cross-commodity hedge exemption to a majority of enumerated exemptions and the pass-through provisions under paragraph (2) of the “bona fide hedging” definition⁵,
3. Provides a standard requiring that the value of the relevant position be “substantially related” to the fluctuations in value of the actual or anticipated cash position or pass-through swap and removes the previously proposed quantitative correlation requirement,
4. Limits federal position limits in energy commodities to the spot month and provides exchanges flexibility to set limits and/or accountability levels outside of the spot month in a manner that balances market liquidity with deterring manipulation and price distortion,
5. Eliminates the regulatory requirement for the “5-day rule” for the enumerated hedges for federal limits which will help facilitate liquidity during the expiry period even though the exchanges retain the discretion to include this type of trading limitation ⁶,
6. Allows for co-existing processes for either the Commission or the exchanges to grant additional exemptions for bona fide hedging transactions which are not otherwise captured within the enumerated hedges⁷,
7. Creates flexibility for organizations to structure bona fide hedging programs on an enterprise-wide gross or net basis or at a portfolio level within a specific entity, and
8. Simplifies market participant reporting, for example, by eliminating the unnecessary and duplicative large trader report.

⁵ Proposal at 11609.

⁶ NGSAs notes that exchanges are still required to notify the Commission under §150.9(e)(2)(vi) of whether the position subject to an application to exceed federal speculative position limits on a referenced contract may be maintained during the last five days of trading during the spot month. NGSAs recommends removal of this notification requirement as inconsistent with the removal otherwise of any 5-day limitations. See Proposal at proposed § 150.9(e)(2)(vi).

⁷ The NGSAs does recommend an expedited process in the short term to address recovery related hedging exemptions.

The extensive corrections made in the Proposal prove the complexity of the position limits issues but still more work is needed. The areas that need to be addressed in a final rule on position limits fall into three buckets:

- 1) the scope of the bona fide hedge definition and enumerated exemptions specifically
 - a) not limiting the economically appropriate test to “price risk”,
 - b) including storage in the enumerated exemption for merchandising,
 - c) applying the pass-through exemption to affiliates of the bona-fide hedging swap counterparty or pass-through swap counterparty, and
 - d) recognizing portfolio hedging in record-keeping processes for hedge exemptions,
- 2) setting appropriate federal limits to ensure healthy markets
 - a) setting limits that are scaled to reflect the relevant deliverable supply of the Henry Hub natural gas market, and
 - b) removing the conditionality between physical and cash limits,
- 3) ensuring the implementation time-line is supportive of upcoming economic recovery needs.

I. The Statutory Breadth and Flexibility of the "Bona Fide Hedging Position" Definition Must Be Maintained and Enumerated Hedge Exemptions Should Reflect Market Realities.

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 limitations on what constitutes a bona fide hedge. This definition should facilitate hedging rather than restrict it.

In this regard, NGSAs supports the Commission's recognition that 1) trade options adjusted on a futures-equivalent basis constitute cash commodity purchase or sales contracts that underlie bona fide hedge positions (and that trade options are not themselves subject to position limits as "referenced contracts,") 2) anticipatory merchandising⁸ are listed as enumerated bona fide hedging positions; 3) additional enumerated hedges have been included to further provide efficiency and certainty to the market and 4) the incidental test and orderly trading requirement from the bona fide hedging definition for physical commodities has been eliminated.

Each of these changes eliminates requirements or restrictions that otherwise may have prevented end users in the natural gas and other industries from hedging common

⁸ See Proposal at 11612, footnote 105. Storage hedge and hedges of assets owned or anticipated to be owned are not considered anticipatory merchandising hedges. Market participants seeking storage hedges would need to do so through the non-enumerated process.

market risks consistent with the statutory criteria that Congress provided for exemption. However, the Proposal still contains certain other requirements and restrictions that should be removed from the proposed regulatory definition.

A. The “Economically Appropriate” Criterion within the Definition of “Bona Fide Hedging Transactions or Positions” should not be Arbitrarily Limited to Price Risk and Especially Not to Fixed-Price Risk.

The "economically appropriate" criterion within the definition of "bona fide hedging transactions or positions" should not be arbitrarily limited to price risk, and especially not to fixed-price risk. As pointed out in the commentary in the Proposal 1) “the current bona fide hedging definition in § 1.3 was developed at the time when only agricultural commodities were subject to federal limits” and such definition has not been updated since 1987 and 2) the previous enumerated hedges were too narrow to “reflect common commercial hedging practices, including for metal and energy contracts” as those markets have grown.⁹

The Commission in proposing to narrow the “economically appropriate” criterion to “price risk” refers to the risks that could be identified upon original promulgation of the rule in 1977.¹⁰ While this history is certainly of some utility to understand the market concerns at that time, the market has clearly evolved to recognize various other risks including operational risk, liquidity risk, credit risk, locational risk and seasonal risk. To delink risk management and price risk is antithetical to the market mechanics which create price risk. **It is the management of risk that creates a market signal which then affects the price.** It does not make sense that risk can therefore be managed as a bona fide hedge transaction or position only once that risk is reflected as price risk. The plain language of §4a(c)(2)(A)(ii) of the Commodity Exchange Act (“CEA”) provides that bona fide hedging positions be “economically appropriate to the reduction of *risks* in the conduct and management of a commercial enterprise. *{emphasis added}*” In short, the Commission is proposing a change that is unneeded. The current standard has embedded flexibility. The Commission should avoid placing limitations on already inherent flexibility.

The Commission also expresses concern with introducing a subjective element to the evaluation of whether a bona fide hedge can be claimed. The intent of the bona fide hedge definition is to specifically allow a market participant to apply for position limit relief outside of the self-effectuating enumerated hedge exemption process. This consideration in and of itself must have some level of subjectivity to allow the market flexibility to continue to innovate in its management of risk. The Commission routinely relies on the experience and expertise of the exchanges in administering the bona fide hedging transaction and position exemption application process and can likewise rely

⁹ See Proposal at 11604.

¹⁰ See Proposal at 11604, footnote 66.

on the expertise of the exchanges regarding determinations of acceptable risk management position exemptions. Both CME and ICE maintain and routinely administer such exemptions.¹¹

To qualify as a bona fide hedge, the transaction or position must meet all three elements of the general bona fide hedging definition, the “temporary substitute” test, the “economically appropriate test” and the “change in value requirement”. **NGSA is concerned that by limiting the “economically appropriate test” to price risk, the Commission will effectively forestall the industry from managing seen and unforeseen (to date) risks to the detriment of effective risk management and ultimately therefore to the detriment of the market.** Particularly in light of the intended narrowing of other risk management hedges through the removal of the word “normally” from the “temporary substitute” test¹², these two changes in combination will have the unintended consequence of removing otherwise acceptable risk management tools from the definition of bona fide hedging transactions or positions. Maintaining the language at “risk” rather than the proposed change to “price risk” provides the flexibility necessary for the energy market to continue to evolve and adapt in ways otherwise unaddressed or unanticipated by the current enumerated hedge exemptions.¹³

Finally, NGSAs requests that the Commission unambiguously recognize that an economically appropriate hedge *can retain* an exposure to a floating or index price.¹⁴ Hedges that retain an exposure to a floating or index price are recognized by the exchanges for position limit exemptions today.¹⁵

¹¹ See CME Rulebook, Chapter 5, Rule 559.B *available at* <https://www.cmegroup.com/content/dam/cmegroup/rulebook/NYMEX/1/5.pdf>. ICE Rulebook, Chapter 6, Rule 6.29(d)(ii) and Rule 6.29(f) *available at* https://www.theice.com/publicdocs/rulebooks/futures_us/6_Regulatory.pdf.

¹² NGSAs is not commenting here on whether it agrees with the Commission interpretation that the removal of the word “normally” from the bona fide hedging definition in § 4a(c)(2)(A)(i) is intended to be congressional direction that a bona fide hedging position in physical commodities must *always* be in connection with the production, sale or use of a physical cash-market commodity. Proposal at 11605.

¹³ The Commission should also make conforming changes to § 150.9(b)(3) to reflect the fact that risk can be considered in the bona fide hedging transactions or positions application.

¹⁴ NGSAs addressed this issue in its joint position limits comment letter filed on July 13, 2016 with the National Corn Growers Association. This issue is also addressed in the Commercial Energy Working Group’s Request for Exemptive Relief No. 3 and is referred to as the Unpriced Physical Purchase or Sale Commitments example (the so-called one leg down, one leg open example).

¹⁵ See CME Rulebook, Chapter 5, Rule 559.B *available at* <https://www.cmegroup.com/content/dam/cmegroup/rulebook/NYMEX/1/5.pdf>. ICE Rulebook, Chapter 6, Rule 6.29(f) *available at* https://www.theice.com/publicdocs/rulebooks/futures_us/6_Regulatory.pdf.

B. The Commission Should Include Anticipated Storage Positions in the Anticipated Merchandising Enumerated Hedge Exemption in Order to Reflect Market Realities.

The Commission should allow for anticipated storage positions to be considered as falling within the enumerated hedge exemption for anticipated merchandising as such hedges are routinely recognized for a bona fide hedge exemption by the exchanges. In support, it is common for natural gas market participants (i.e. natural gas producers, electric power generation facilities, industrial consumers, and utilities) to deliver natural gas into storage during the shoulder months of April and May and throughout the summer season for withdrawal during the winter.¹⁶

In the market participant's analysis of storage, the market participant will model the cost of the empty storage, which includes the injection, storage and withdrawal fees. The natural gas short on the front end is evaluated relative to the long on the back end to determine if storage is a worthwhile expenditure. To hedge the anticipated value of the "investment" in storage, the market participant may sell the natural gas forward using a Henry Hub futures contract.

Differentiating the U.S. natural gas market from other natural gas markets around the world, the U.S. ability to store natural gas for use during the winter season is unrivaled and vital part of the U.S. natural gas market flexibility. On an average winter day withdrawals from storage are used to supply 10-15 percent of domestic natural gas demand.¹⁷ The U.S. Energy Information Administration ("EIA") notes that natural gas storage can play an even more significant role during times of peak natural gas demand in the winter because generally, changes in natural gas storage are correlated with changes in temperature.¹⁸ Natural gas storage is key to the industry's reliability and flexibility and provides a great, simple example of a physical hedge. Recognizing natural gas storage hedges as included in the anticipatory merchandising enumerated hedge will assure market participants of expedient regulatory certainty surrounding the hedging activities that support a critical aspect of natural gas market reliability.

¹⁶ For the natural gas market, the summer season is considered the seven-month period of April 1 to October 31. Consequently, the winter season is November 1 to March 31.

¹⁷ See NGSAs 2019-2020 Winter Outlook where average storage withdrawal of 12.3 Bcf/day shown on Slide 12 is divided by total natural gas demand of 109.3 Bcf/day shown on Slide 7 equals 11 percent and provides a rough estimate for the significance of natural gas storage capability. The role that storage plays in the market varies regionally, daily and from year to year depending on market conditions.

¹⁸ See U.S. Energy Information Today in Energy article from January 5, 2018 *available at* <https://www.eia.gov/todayinenergy/detail.php?id=34412>

C. Broadening the Pass-Through Provisions to Incorporate Transactions or Positions Among Affiliates Facilitates Market Liquidity Vital to Affordable Hedging.

The Commission should broaden the pass-through provisions in its definition of "bona fide hedging position" to allow affiliates to pass through their bona fide hedge position exemption to an affiliate who then transacts with the market. Further, a market participant making the outward or market-facing transaction that effectuates the bona fide hedge transaction for the affiliate must be able to similarly lay off the risk of the market-facing transaction through a bona fide hedge exemption if needed. Market-facing, "treasury affiliate" subsidiaries within a corporate structure include centralized derivatives-trading or financing affiliates. Such corporate structures are common approaches to streamlining capital costs. This type of treasury function has been broadly recognized by the Commission throughout the years.¹⁹ Corporate organizations making use of these structures should not be effectively prevented from making use of the pass-through exemption. Broadening the pass-through provisions in the definition of "bona fide hedging transactions or positions" to allow affiliate pass through would serve the equitable purpose of allowing more market participants to make the most efficient and effective use of their existing corporate structures. **Market participant access to affordable hedging must be corporate structure neutral.**²⁰ Corporate structure neutrality in the pass-through provisions benefits both large and small market participants by facilitating market liquidity and hedge efficiency.

¹⁹ 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 later codified as 7 U.S.C §2(h)(7).

²⁰ Contrary to common assertions, this issue is not always solved by the aggregation rules in 17 C.F.R. § 150.4 (which would net out the applicable pass-through swap and swap offset positions). Specifically, such [treasury] affiliates may be exempt from aggregation under one of the several bases for exemption in 17 C.F.R § 150.4(b). 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 17 C.F.R § 150.4(b)(7)), from making use of the bona fide hedge exemption for an identical set of transactions. Alternatively, where the affiliate that ultimately takes the risk chooses to warehouse the risk and not lay it off in the market, the positions would not simply "net out" under the aggregation rule. 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 related transactions within a corporate family should get the benefit of the pass-through exemption.

D. The Exchanges Recordkeeping and Reporting Rules must be Flexible Enough to Accommodate Portfolio Hedging by Market Participants.

NGSA appreciates the work that the Commission has done to recognize and accommodate portfolio hedging, specifically in allowing market participants to net non-spot month positions in linked physically-settled and cash-settled referenced contracts.²¹ The Commission should clarify that the exchange recordkeeping and any follow on reporting requirements for bona fide hedging transactions and positions should not require matching applicant's 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. 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 recordkeeping requirements under Proposal §150.9(d) should also apply to trading positions on an aggregate basis, thus allowing for portfolio hedging.

II. Appropriately-Set Federal Limits Are Essential to Healthy Markets.

The Commission must ensure that any new 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 and expedient opportunities for end users to hedge their commercial risks using derivatives. To ensure that such opportunities exist, it is essential that federal speculative 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. It is unrealistic to think that long hedge positions in any derivatives market will perfectly and efficiently match the short hedge positions. **Inherently, efficient and affordable hedging depends on the**

²¹ Proposal at 11678.

presence of speculation. Therefore, it is important that position limits not be set too low or be encumbered with unnecessary restrictions.

A. The Federal Spot Month Limit for the Physically-Settled Natural Gas Futures Contract Must Reflect Full Delivery Flexibility.

To optimize liquidity in the NYMEX Physically-Settled Natural Gas Henry Hub Contract (“NG Contract”) and harmonize the federal 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 transportation capacity available now at Henry Hub provided by displacement and the increasing capacity which is coming from future but imminent displacement. As the Commission has recognized in previous proposed rulemakings, 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.”²² As such, the spot month limit should reflect some room to grow so as to avoid anticompetitive effects. It is important to note that the exchange-set limit must fall at or below the federal spot month limit. **The important point here is that the federal spot month limit should provide ample room for expedient exchange rule adaptation to the market.**

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 entire U.S. natural gas market, as well as many global LNG market participants. Therefore, it is essential that end users have access to a robust market in the NG Contract with counterparties having substantial trading capacity. Perhaps even more important than the scale of the federal spot month limit relative to the scale of the market, the federal spot month limit is simply unduly restrictive with respect to the delivery capability at of the Henry Hub given the effective capacity of the pipeline system that links to the physical location of Henry Hub.

The federal spot month limit on the NG Contract must recognize the additional supply available at Henry Hub provided by 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

²² Position Limits for Derivatives, 78 Fed. Reg. 75680 (Dec. 12, 2013) at 75729; *see also* Position Limits for Derivatives Reproposal, 81 Fed. Reg. 96719 (December 20, 2016).

backhaul makes efficient use of capacity – creating additional supply alternatives for shippers and enhancing competition on the pipeline system.²³

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. As explained in the CME’s Analysis of Deliverable Supply, Henry Hub Natural Gas Futures (“DSE”), displacement can occur at any interconnect or point(s) on a natural gas pipeline system when volumes nominated and scheduled to flow in one direction are displaced by volumes nominated and scheduled to flow in the opposite direction.”²⁴ In the DSE, CME included displacement in its methodology utilizing Design and Available capacities data provided by EnLink Midstream, the pipeline operator at Henry Hub, from October 31, 2012 to July 31, 2018.²⁵

Ultimately constraining the exchange-set limits, adequate federal speculative limits will be vital to ensuring well-functioning energy over-the-counter markets. The Commission's estimates of deliverable supply at Henry Hub should recognize the full capability of the natural gas pipeline delivery system.²⁶ The full capability of the natural gas pipeline delivery system, including displacement, must be the foundation of the federal speculative limit for the physically settled natural gas futures contract. **Federal spot month speculative position limits, must fit the operational realities of the market, in this case, the Henry Hub market and be expansive enough to support a market recovery and growth.**

B. Higher Spot Month Limit on the Cash-Settled Natural Gas Contracts Must Be Available to Market Participants *Without Condition*.

NGSA supports the Proposal'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.²⁷ Noted many times before, markets function well where position limits are set appropriately.

²³ 101 FERC ¶ 61, 127 at p. 54 (Oct. 31, 2002).

²⁴ See DSE at 5.

²⁵ DSE at 5.

²⁶ As noted in the DSE at 5-6, the frequency and the magnitude of the market activity at Henry Hub activity has increased due to a number of major market developments including 1) the shale revolution redefining the supply structure; 2) the Northeast becoming a net exporter displacing excess gas to other markets including the major historical production basin, the US Gulf Coast and 3) US Gulf Coast shifting to a major consumption hub with LNG export terminals.

²⁷ The proposed multiplier approach for natural gas, where the speculative limits for cash settled natural gas futures contracts is a workable and transparent approach, that recognizes the importance of allowing “space” in cash-settled markets for larger speculative positions. Equally viable approaches for establishing speculative limits in natural gas cash-settled futures markets worth consideration *include* basing the speculative limit on open interest or perhaps the delivery capacity for the entire S&P Global

To be consistent with the CEA's requirements and the Commission's own well-established policies, position limits must focus on (1) facilitating orderly settlement of contracts and convergence between physical and financial markets and (2) preventing market manipulation, e.g. corners and squeezes, between physical and financial markets. This is best accomplished by focusing the position limits in the final rule on physical delivery contracts in the spot month. This approach correctly focuses the speculative position limits on contracts where there is the greatest potential for speculative activity in the futures market to influence physical market prices – the physically-settled, spot-month contract. Importantly, the approach allows limits on cash-settled contracts in the spot-month, where appropriate for the given commodity market, to be substantially raised to provide a place in the financial markets for larger commercial and speculative positions to be held – away from physically-settled contracts.

The CEA requires the position limits established by the Commission to be both “necessary” and “appropriate” for preventing “excessive speculation . . . causing sudden or unreasonable fluctuations or unwarranted changes in [] price” and “market manipulation, squeezes or corners,” while at the same time ensuring “sufficient market liquidity for bona fide hedgers” and non-disruption of “the price discovery function of the underlying market.”²⁸ Where spot-month position limits on cash-settled contracts are retained, **the higher limits for cash-settled contracts should be maintained and should not be limited to traders that only hold cash-settled positions.** In other words, there should be “no condition” or regulatory requirement to divest of the physically-settled contract to obtain access to higher limits for cash-settled contracts. Rather, the *separate treatment* of cash-settled and physical-delivery contracts position limits under § 150.2(a) should be maintained and the exemption in § 150.3(a)(4) removed.

Importantly, akin to forcing a consumer to choose either an apple or an orange but not both, this conditionality creates a regulatory structure that intrinsically supports one product over another and by extension, one exchange over another. The market participant must choose an exchange in order to have access to the limit structure that best suits the regulatorily created need. At its worst, conditionality is anti-competitive.

Market participants are best served by the availability of a diverse array of hedging tools. Natural gas market participants are blessed with an abundance of hedging options that include multiple futures exchanges, diverse physical commercial services and bespoke, bilateral over-the-counter transactions. The “conditionality” removes important hedging optionality for physical market participants. Physical market participants currently hedge Henry Hub price risk through both physically settled and financially-settled futures contracts. To the extent market participants want

Platts “Henry Hub” pricing region which is broader than the physical location of Henry Hub in Erath, LA.

²⁸ See CEA §§ 4a(1), (3)(B).

access to higher speculative limits for cash-settled futures contracts, the market participant must forgo the ability to hedge using the physically-settled futures market and must instead only hedge through the financially-settled futures market, unnecessarily limiting hedging flexibility.

A regulatory “condition” that the trader hold no spot-month position in the physical-delivery contract in order to access higher speculative limits in the cash-settled futures market has the potential to harm the market for the physical delivery contract by moving liquidity in the spot-month period from the physically-settled futures market to the cash-settled contract at a time when the prices are being settled. Ironically, the effect of the condition *removes* those market participants with an economic interest in the settlement of the physically settled futures contract from participation in the market during the settlement window. In other words, the “conditionality” means that customer-facing physical market participants, that qualify for a bona fide hedge exemption and provide liquidity into the market, are excluded from holding a position during the settlement period for the physically-settled natural gas futures contract if the market participant desires access to higher speculative limits in the cash-settled futures contract market. Convergence is facilitated through unencumbered simultaneous market participant access to *all* futures market options and federal speculative limits must be set according to the individual characteristics of the futures contracts.

Further, it is unclear how conditionality may impact NG Contract look-alike swaps and whether NG Contract look-alike swaps would be captured by the requirement to exit spot month physical-delivery referenced contracts in natural gas pursuant to §150.3(a)(4)(iii) in the Proposal. Since NG Contract look-alike swaps are not physically settled they are not subject to the identified potential manipulation risks and therefore these contracts should not be subject of the exit condition. In short, conditionality creates otherwise avoidable uncertainty for how it may or may not extend into and impact OTC markets.

The Commission should simply eliminate the condition and address the Commission's underlying concerns using more tailored means. The Commission's stated concern in the Proposal was to “prevent manipulation by traders with leveraged positions in the cash-settled contracts (in comparison to the level of the limit in the physical-delivery contract) who might otherwise attempt to mark the close or distort physical-delivery prices in the physically-settled contract to benefit their leveraged cash-settled positions.”²⁹

This concern purportedly comes from the two referenced circumstances, the Hunt family accumulation of silver in 1979 and 1980 and the Amaranth Advisors L.L.C.

²⁹ Proposal at 11640.

manipulation in 2006.³⁰ Both these circumstances arose prior to Congress providing enhanced anti-manipulation enforcement authority to the Commission as part of the Dodd-Frank Act which has proved to be an effective tool for the Commission in aggressively combatting manipulation. Simply put, the Commission must use the tailored measures provided by the Commission's enhanced antimanipulation authority 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.³¹ **By employing such measures, which can be more precisely tailored to the risks of manipulative and disruptive trading practices, the Commission can avoid causing needless harm to liquidity in the physically-delivered spot month contract by removing the physical divestiture condition.**

III. Implementation of the Rule Must Be Phased to Help Facilitate Economic Recovery.

Establishing the right limits, based on the unique characteristics of the individual commodity markets and the form of settlement, *i.e.* physical or cash, is critical to ensuring continued well-functioning markets. Natural gas markets are in fact unique and the Proposal recognizes this through many important exceptions for natural gas market transactions.

In addition to establishing a robust hedge exemption process and appropriate limits, *when and how* the speculative federal limits and the associated new regulatory framework are applied are equally important.

Natural gas futures contracts are listed on multiple exchanges. Differentiating natural gas markets, the Proposal would also expand the "economically equivalent" criteria to sweep the ICE Henry Hub Penultimate contract into the federal speculative position limits framework. Establishing and implementing a federal speculative position limits regulatory framework for the exchanges that list natural gas futures and economically equivalent contracts is a significant and complex undertaking.

In addition to the exchange traded futures and look-alike contract impacts, the Proposal includes a workable self-regulatory approach to include OTC energy markets in the federal position limits regime. However, given the unfolding events of the last few months, economic recovery will depend on healthy, flexible, and innovative markets and OTC energy markets are poised to play an important role in economic recovery, as the market has in years past.

³⁰ Proposal at 11665.

³¹ See CEA §§ 4c, 6(c).

The point is this, the recent period of relatively low volatility was facilitated by the investments that were made possible by hedging in the pre-2008 decade. These investments fueled the technological breakthrough that resulted in a visible step-change in energy market conditions that is spurring the further investments previously noted. Investments are facilitated by sound market signals and affordable hedging. Affordable hedging is facilitated by liquidity and hedging tool diversity. It is a daisy chain. Investments in energy and consequently the market, the regulatory structure, and the hedging tools behind the investments, will continue to be of primary importance in an era of post-epidemic recovery.

Since the time of the market-changing technological breakthroughs and the implementation of Dodd-Frank, the natural gas market has been relatively flat, and ICE has converted to a futures exchange. Interestingly, while the OTC natural gas market is simply not the scale that it was during the time leading up to Dodd-Frank, OTC markets play an important role in investment and market evolution. **OTC markets are an incubator for affordable bespoke hedges that are key ingredients, the seedlings, to healthy, evolving markets.**

At present, global financial markets are in uncharted territory. The price tag for a mistake is high and implementing an entirely new regulatory regime on over-the-counter energy markets at a time of unprecedented uncertainty is a risk that can and should be avoided. NGSA urges the Commission to move forward with the proposed self-regulatory approach for sweeping energy OTC markets into the Proposed federal speculative limits regime but phase-in the effective date for the inclusion of the over-the-counter energy markets by one additional year which would be twenty-four months following the rule's effective date. The phased-in effectiveness of the new position limits rules will allow market participants to use OTC markets as an incubator that supports economic recovery *before* shifting focus to building an entirely new regulatory compliance framework. Phased-in effective dates also allow the learnings that stem from the implementation the exchange-traded energy markets to inform and facilitate the subsequent seamless implementation of the complex OTC regulatory framework.

NGSA acknowledges that the CEA provides that when the Commission establishes "the amount of position limits" on futures and options on futures pursuant to §4a(a)(2), the Commission should also simultaneously establish "the amount of position limits" on economically equivalent swaps, pursuant to CEA §4a(a)(5).³² **The question is whether "establish limits on the amount of positions" simultaneously means to *implement* such limits or simply**

³² Legislative history gathered from the House of Representatives Hearing to Review Implementation of Provisions of the Dodd Frank Wall Street Reform and Consumer Protection Act Relating to Position Limits, December 15, 2010 suggests, as per the Statement of Terrance A. Duffy, Executive Chairman, CME Group Inc, p. 42 that this simultaneous requirement was established with the intent "to prevent a flight of trading from regulated exchanges with no limits to unregulated markets with limits".

determine the amount of the limits as per the plain language. We believe it is the latter.

The OTC energy markets play a critical role in affordable hedging and the application of the new rules to the OTC markets are the most difficult to get right. Investments rest at the heart of rapidly evolving energy markets. **Rather than experimenting with the implementation of an entirely new regulatory structure on OTC energy markets during unprecedented times, the application of the new regulatory framework to OTC swaps should be sequentially phased-in to avoid the risk of harm to market recovery and to facilitate efficiency in market participant implementation.**

CONCLUSION

Diving into the uncharted waters of sweeping energy markets into federal speculative trading limits is a high stakes complex endeavor. The right regulatory framework is essential to affordable and effective risk management that is an important part of energy sector investment. Three things need to be ensured in a regulatory path forward: 1) current hedging practices must be recognized, 2) the federal limits must be appropriately set, and 3) limits must be appropriately applied.

The changes and clarifications to the Proposal 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.

Established in 1965, NGSAs represent integrated and independent companies that produce and market natural gas consumed in the United States. NGSAs encourage the use of natural gas within a balanced national energy policy and advocate for well-functioning markets that foster a growing, competitive market for natural gas. NGSAs are dedicated to achieving a cleaner future through strong partnerships with renewables and supporting innovative technologies and market solutions that reduce emissions.

NGSA members invest in the growth of the physical natural gas markets because they believe the market exhibits three key principles of health -- integrity, transparency, and efficiency. NGSAs believe that its requested modifications to the Proposal will further promote these principles and respectfully requests the Commission's consideration of these comments.

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,

A handwritten signature in black ink that reads "Fordham". The signature is written in a cursive, flowing style with a long horizontal stroke at the end.

Jennifer Fordham
NACD Governance Fellow
Senior Vice President, Government Affairs
Natural Gas Supply Association
900 17th Street, NW, Suite 500
Direct: 202-326-9317
e-mail: jfordham@ngsa.org