July 13, 2016

Via Electronic Submission

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

Re: Comments of the American Gas Association, CFTC Supplemental Notice of Proposed Rulemaking, Position Limits for Derivatives: Certain Exemptions and Guidance, RIN 3038-AD99

Dear Mr. Kirkpatrick:

Pursuant to the request for comments, the American Gas Association (“AGA”) respectfully provides these comments on the Commodity Futures Trading Commission’s (“CFTC”) Supplemental Notice of Proposed Rulemaking on Position Limits for Derivatives: Certain Exemptions and Guidance (“Supplemental NOPR”).¹

AGA supports the CFTC’s continued efforts to ensure that the CFTC-regulated markets related to energy commodities function efficiently for the benefit of commercial end-users. AGA appreciates the CFTC’s statutory obligation under the Commodity Exchange Act (“CEA”) to adopt position limits on speculative trading activity to ensure that the commodity markets are free from excessive speculation. But AGA also emphasizes (again, consistent with the mandate of the CEA) that any speculative position limits regime must be established in a way that allows commercial end-users, such as gas utilities, to continue to enter into bona fide hedges to manage, hedge and mitigate the commercial risks of their natural gas distribution business in a cost-effective manner on behalf of customers.

In the reopening of this proceeding, the CFTC proposes revisions and additions to regulations and guidance proposed in the 2013 Position Limits NOPR² specifically related to a new alternative process for CFTC-regulated futures exchanges (“Exchanges”) and registered swap execution facilities (“SEFs”) to: 1) recognize non-enumerated bona fide hedging (“NEBFH”) positions; 2) recognize enumerated anticipatory bona fide hedging positions; and 3) grant spread exemptions, in each case subject to CFTC oversight and review. AGA appreciates the CFTC’s efforts, in response to comments and viewpoints expressed during roundtables and advisory committee meetings held on this topic, to draw upon the resources and experience of the Exchanges to review and recognize positions as bona fide hedges for purposes of the federal limits. In particular, AGA supports the concept that Exchanges have the expertise, experience and should have the authority to review and recognize NEBFH requests, to conserve limited CFTC resources

while helping to ensure that the review and recognition of a request is performed in a timely, streamlined and efficient manner.

AGA believes that the proposed alternative process must be reasonable and workable for all market participants. AGA is concerned, however, that the Supplemental NOPR’s requirements as drafted are overly prescriptive and burdensome on both the Exchanges and the market participants that may seek to use the alternative process. Therefore, AGA respectfully recommends that the CFTC modify its proposal in this proceeding to alleviate unnecessary and unduly restrictive burdens on market participants, as further discussed herein. In addition, to provide regulatory certainty, commercial end-users need to hedge long-term commercial risks using Referenced Contracts, and to eliminate duplication of Exchange and CFTC efforts, AGA respectfully requests that the CFTC allow the Exchanges, as self-regulatory organizations, to issue binding determinations on NEBFH and other exemptions, subject to CFTC review of such Exchange determinations during a specified review period, as discussed further herein. If the CFTC decides to revise or revoke such an Exchange exemption, commercial end-users must be allowed adequate time to adjust or amend positions, or enter into alternative hedging transactions, in a manner consistent with commercial risk hedging strategies in the applicable industry. For some end-users, including utilities, adjusting such strategies may require approval from a state regulator, a corporate or enterprise risk management committee, or other governing body.

I. Communications

All correspondence in regard to this proceeding should be delivered to the following:

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II. Identity and Interests

The AGA, founded in 1918, represents more than 200 local energy companies that deliver clean natural gas throughout the United States. There are more than 72 million residential, commercial and industrial natural gas customers in the U.S., of which 95 percent – just under 69 million customers – receive their gas from AGA members. AGA is an advocate for local natural gas utility companies and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international gas companies and industry associates. Today, natural gas meets more than one-fourth of the United States’ energy needs.3

AGA’s members enter into commercial risk management transactions in markets regulated by the CFTC. AGA member companies’ principal business is to provide natural gas local distribution services to residential, commercial and industrial customers under rates, terms and conditions that are regulated at the local level by a state commission or other regulatory authority with jurisdiction. In most cases, this regards the procurement and provision of physical natural gas

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3 For more information, please visit www.aga.org.
commodity for use by customers in equipment in their homes and businesses, and the distribution of
that natural gas commodity to such homes and businesses. To ensure reasonable rates for the
natural gas commodity that is provided to natural gas utility customers, AGA’s members engage in
risk management transactions in markets regulated by the CFTC. Many gas utilities also use a
variety of commercial risk hedging tools, such as futures contracts traded on CFTC-regulated
exchanges and over-the-counter (“OTC”) energy derivatives, to hedge or mitigate the commercial
risks associated with providing safe, reliable and cost-effective natural gas service to its customers.

III. Comments

A. Certain Proposed Bona Fide Hedge Exemptions Remain Pending

As a preliminary matter, the Supplemental NOPR must be read in conjunction with the 2013
Position Limits NOPR. Given the numerous record re-openings, comments at Energy and
Environmental Markets Advisory Committee (“EEMAC”) meetings, and the length of time the
original 2013 Position Limits NOPR has been pending, it is difficult to fully assess the impacts of
the Supplemental NOPR on market participants. For example, AGA notes that it addressed in prior
comments the impact on AGA members by the proposed bona fide hedge exemption for utility sales
and the proposed anticipated merchandising hedge exemption. There is broad support for the
proposed bona fide hedge exemptions for utility sales, and for anticipated merchandising, and AGA
again urges the CFTC to address the utility sales hedge exemption, and include anticipatory
merchandising among its final list of enumerated hedges. However, without knowing how those
two hedges will be addressed in the final rule, it is not clear how and to what extent the proposal in
the Supplemental NOPR for Exchanges to review and recognize non-enumerated hedge exemptions
will impact AGA members.

Because of this interconnection between these issues in the 2013 Position Limits NOPR and
the Supplemental NOPR, we will briefly note AGA’s prior comments on these topics. AGA filed
comments on the 2013 Position Limits NOPR supporting the newly proposed bona fide hedge
exemption for utility resales, but requesting further important clarification of the proposed
regulatory text. The CFTC proposed an enumerated exemption for utilities, such as AGA’s
members, to hedge unfilled anticipated customer requirements. The proposed exemption would
apply to long positions in commodity derivative contracts that do not exceed in quantity unfilled
anticipated requirements of the same cash commodity for resale by a utility that is “required” or
“encouraged” to hedge by its public utility commission on behalf of its customers’ anticipated use.
AGA’s comments expressed concern that this proposed utility hedge exemption as defined is
unduly limiting and too restrictive to satisfy its intended purpose. Since state regulatory authorities
vary significantly in how a utility’s risk management program is reviewed, AGA encouraged the

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10022 (February 25, 2015).
6 The EEMAC meeting transcripts and presentations are available at:
7 AGA Comments in RIN 3038-AD99 filed on February 10, 2014; AGA reaffirms these comments herein.
9 For example, more commonly the local regulator “permits” or “allows” hedging.
CFTC to revise the definition of the exemption to allow for more effective use by utilities of the bona fide hedge exemption for its risk management transactions on behalf of its customers.

AGA also commented that hedge exemptions for unfilled anticipated requirements and unsold anticipated production should apply equally to unpriced anticipated requirements and unpriced anticipated production. AGA explained that utilities, such as AGA’s members, typically enter into contracts to purchase natural gas with respect to anticipated customer requirements months, or even years, in advance of a particular anticipated delivery period in order to ensure that sufficient natural gas supply is available to provide safe and reliable service to customers. For forward contracts with floating prices based on monthly or daily price indices compiled independently and published in a number of industry publications, while the portion of these utilities’ anticipated customer requirements acquired through these index-priced contracts is no longer unfilled, and from their suppliers’ standpoint the portion of anticipated production represented by these contracts no longer remains unsold, these contracts effectively remain unpriced and exposed to price risk. AGA thus requested clarification that the CFTC’s proposed bona fide hedge exemptions related to unfilled anticipated requirements and unsold anticipated production also apply to this circumstance.

Further, in supplemental comments, 10 AGA expressed support, along with other EEMAC members, for adding a proposed Anticipatory Merchandising Hedge (“AMH”) to the list of enumerated hedges for qualifying hedgers of storage or transportation assets (and any other anticipated merchandising of natural gas) for the reasons already fully set forth in the record in this rulemaking proceeding. AGA stated that the preclusion of such activity, or a piecemeal petition process to permit it, would reduce liquidity and severely constrain, raise costs for, and create undue risk for gas utilities – without any benefit to the CFTC’s interest in reducing excessive speculative activity. 11

AGA appreciates the CFTC’s proposed bona fide hedge exemption for utility resales and the opportunity to provide comments which AGA believes will further fine-tune the proposal so that it may be used by utilities for the purposes for which it is intended. 12 AGA also supports the addition of the proposed AMH to the list of enumerated hedges for qualifying hedgers of storage or transportation assets (and any other anticipated merchandising of natural gas) because the addition will protect and preserve natural gas utilities’ and their counterparties’ ability to freely transact in ordinary commercial hedging activities tied to gas storage assets. Additionally, AGA urges the CFTC to expressly provide in any final rule that its speculative position limits will not apply to commodity trade options as previously discussed by the CFTC in its order amending the trade options regulations. 13

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10 AGA Supplemental Comments in RIN 3038-AD99 filed on March 30, 2015; AGA reaffirms these comments herein.


12 Again, rather than “requiring” or “encouraging” gas utility hedging, it is more commonly the case that local regulators “permit” or “allow” it and review or otherwise have oversight over such activities in various ways. See 81 Fed. Reg. 14966 at 14971 (Mar. 2016).
It is important that the list of enumerated hedges does not unreasonably restrict or eliminate certain hedging strategies commonly used by gas utilities to reduce gas price commodity risk because the cost of doing so is ultimately one borne by consumers. AGA thus respectfully urges the CFTC to consider these prior comments as the issues are important to gas utilities’ businesses as it moves forward to finalize the position limits rule.

In the event that AGA’s requested modifications are not accepted in the final rule, though, the new process for NEBFH requests – as an alternative to seeking an interpretive letter or CFTC exemption – will take on increased importance for AGA’s members. As noted above, AGA believes that this process must be reasonable and workable for all market participants. Accordingly, we now turn to this issue.

B. Reasonable Requirements Should Apply to the Proposed NEBFH Recognition Process

In the Supplemental NOPR, the CFTC proposes an alternative process to permit Exchanges to recognize NEBFHs with respect to the proposed federal speculative position limits. The CFTC proposes that an Exchange, as a self-regulatory organization (“SRO”) that is under CFTC oversight and whose rules are subject to CFTC review, could establish rules under which the Exchange would recognize as NEBFH positions that meet the general definition of a bona fide hedging position. The CFTC explains that an Exchange recognition of a position as a NEBFH would allow the market participant to exceed the federal position limit to the extent that it relied upon the Exchange’s recognition unless and until such time that the CFTC notified the market participant to the contrary.

Market Participant Requirements. The CFTC proposes to require that all NEBFH applicants submit to an Exchange certain detailed factual statements and representations, including: (i) a description of the position in the commodity derivative contract for which the application is submitted and the offsetting cash positions; (ii) a statement concerning the maximum size of all gross positions in derivative contracts to be acquired during the year after the application is submitted; (iii) detailed information regarding the applicant’s activity in the cash markets for the commodity underlying the position for which the application is submitted during the past three (3) years; and (iv) detailed information to demonstrate why the position satisfies the requirements of CEA section 4a(c) and any other information necessary to enable the Exchange to determine, and the CFTC to verify, whether it is appropriate to recognize such a position as an NEBFH. Further, the CFTC proposes that an Exchange that elects to process NEBFH applications shall have rules requiring an applicant to file a report when such applicant owns or controls a derivative position that such Exchange has recognized as a NEBFH, for the applicant to report the offsetting cash positions, and for the applicant to update and maintain the accuracy of any such report.

The CFTC also proposes certain detailed requirements that an Exchange must include in its rules for the NEBFH application process, including: (i) a person intending to rely on an exchange’s recognition of a position as a NEBFH would be required to submit an application in advance of exceeding the position limit and to reapply at least on an annual basis by updating that application, and to receive notice of recognition in advance of the date that such position would be in excess of the limit then in effect pursuant to section 4a of the CEA; (ii) an exchange must notify an applicant in a timely manner whether the position was recognized as a NEBFH or rejected, including the reasons for any rejection; and (iii) an applicant must have received recognition for a NEBFH
position before such applicant exceeds any limit then in effect, and that the exchange administer the process, and the various steps in the process, in a timely manner.

AGA submits that the proposed requirements for its members, and other end-user applicants, that would seek to use the Exchange process for the recognition of NEBFHs are overly prescriptive and unduly burdensome. For example, the requirement for an applicant to provide detailed information to the Exchange regarding the applicant’s activity in the cash markets for the commodity underlying the position for which the application is submitted during the past three (3) years is vague and restrictive. AGA members may acquire new assets that require hedging, or they may modify their business strategy or respond to regulatory changes. As a result, three year old data may be stale data that provides little insight in determining whether to recognize a NEBFH position (and in some cases, AGA members may not have three years of cash market data available when applying for a hedge). Exchanges should have the discretion to seek up to three years of data with respect to applications, but such data should not be a fixed prerequisite to obtaining NEBFH recognition. The NEBFH process at Exchanges should be more flexible and should allow applicants to demonstrate their hedge needs in ways other than by three years of cash market data that the Exchange, in the reasonable exercise of its discretion and based on its expertise and experience, deems appropriate. The Exchanges have workable and flexible processes in place now for granting exemptions from position limits in listed products. There is no reason for the CFTC to dictate what the Exchange may request of an applicant.

Additionally, the proposal for Exchanges to require “reports” from applicants is particularly problematic due to its vagueness in terms of the frequency that a cash market report must be provided. In the preamble, the CFTC states that, “[a]t a minimum, these rules should require applicants to report when an NEBFH position has been established.” If the CFTC’s proposal is to require hedgers to report at some point during the course of the year that they enter or exit such a hedge, or re-enter a hedge, such a reporting obligation would be impractical, incredibly burdensome, and without any benefit to the Exchanges or the CFTC’s regulatory efforts to prevent excessive speculation. To address this issue, AGA recommends that the CFTC modify proposed § 150.9(a)(6) to say that Exchange rules on the NEBFH process should require a NEBFH applicant to file a report with the Exchange only if circumstances change from the original application (i.e., a change-in-status), such as no longer owning the asset requiring the hedge.

Exchange Discretion. The Supplemental NOPR proposes the following detailed requirements for an Exchange which elects to process NEBFH applications, including: (i) the position must be in a commodity derivative contract that is a referenced contract; (ii) the Exchange must list such commodity derivative contract for trading; (iii) such commodity derivative contract must be actively traded on such Exchange; (iv) such Exchange must have established position limits for such commodity derivative contract; and (v) such Exchange must have at least one (1) year of experience administering exchange-set position limits for such commodity derivative contract.

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14 AGA members may enter, exit, re-enter, and roll hedges, and may at times enter into hedge positions under a hedge exemption, but not exceed the position limits. It is thus unclear as to when this “report” would be required (e.g., (i) whenever the hedger puts on a hedge regardless of whether it is in fact using its hedge exemption to exceed the limits?; (ii) the first time the limits are exceeded, or upon each instance?; or (iii) for spot month exemptions, only if the limits are exceeded during the spot month?).
In order for the proposed process to be useful to end-users, such as the gas utilities that are AGA members, AGA submits that the Exchanges should have a reasonable amount of discretion to adopt workable, less prescriptive rules to process and recognize NEBFH applications. While the Supplemental NOPR appears to provide Exchanges with the authority to recognize NEBFH requests, the CFTC proposes numerous overly restrictive requirements on the Exchanges which unnecessarily restrict a process that is designed to: i) assist the CFTC in the daily administration of NEBFHs, particularly in light of its limited resources; and ii) provide commercial hedgers with a process that will enable them to obtain recognition of their NEBFH positions in a manner and a timeframe that meets their commercial risk management needs. The onerous and static requirements that would be imposed by the Supplemental NOPR undermine those objectives.

Nor are these requirements necessary. First, because Exchanges may, at any time, request records of hedgers’ cash market and derivative positions or other details and explanations concerning the commercial risks being hedged, any Exchange surveillance function can be met by exchange data inquiries, rather than by an affirmative reporting obligation by a commercial hedger. And second, the CFTC retains the power to approve or disapprove the Exchange’s rules, and to review an Exchange’s compliance with the rules in rule enforcement reviews, which AGA believes under a well-functioning process would provide an effective check on the Exchanges’ exercise of discretion in recognizing NEBFH positions.

Separately, in the event that the CFTC overrides an Exchange determination with respect to an NEBFH or other exemption from speculative position limits, the CFTC would notify the market participants and the market participants would be allowed a commercially reasonable time to reduce any non-conforming derivative positions or otherwise come into compliance with position limits, and substitute another transaction or position to replace the hedge for its commercial risks. The Supplemental NOPR notes that the CFTC believes such a commercially reasonable amount of time generally would be less than one (1) business day. AGA submits that a less than one business day time frame to come into compliance, without substantially upsetting commercial risk hedging programs that some market participants may have built around an Exchange-granted exemption, is unworkable and overly burdensome, particularly for smaller sized commercial end-users.

For some commercial end-users, a corporate or enterprise-wide hedging program for commercial risks arising from ongoing operations may be built around a NEBFH recognition request granted by an Exchange. For some commercial end-users that are utilities, a state or local regulator, or a corporate enterprise risk management committee or governing board, must approve changes to commercial risk hedging policies and strategies. Commercial reasonableness should, like many other aspects of the CEA and CFTC rules, be evaluated based on all relevant facts and circumstances, and not artificially limited to a fixed time period for all market participants in all industries and under all circumstances. AGA recommends that if the CFTC wants to be more specific about what it considers a “commercially reasonable amount of time,” it should expressly refer to the need to take into account all facts and circumstances surrounding the exemption and the Referenced Contracts to which it applies, including commercial end-users that will be affected by the change or revocation of the exemption.

15 See discussion in footnote 168 of the Supplemental NOPR.
AGA respectfully suggests that, in any final rule, the CFTC should provide the regulatory certainty that commercial end-users need from a workable and efficient Exchange process, and to conserve agency resources. The CFTC should allow the Exchanges, as SROs, to continue using the workable exemption processes that are currently in place, as described at the EEMAC meetings. The Exchanges would use their expertise and experience with the industries that use each listed Core Referenced Futures Contract in the first instance, with the CFTC maintaining oversight of the Exchanges’ exemption primarily through rule enforcement reviews. In the event that the CFTC determines that it will review an Exchange determination, it should adopt a rule that follows its current approach under CFTC Rule 1.47. That is, if the CFTC does not reject an Exchange determination within a specified time period (e.g., 30 days for an initial request; and 10 days for a request to increase an exemption level), then the Exchange determination request would be final. In this manner, the CFTC would retain the ultimate authority to override an Exchange’s recognition of a NEBFH, but only during a specified review period so that market participants can have needed certainty regarding their exemptions.

AGA recognizes that at least some elements of the proposed alternative process have their roots in the CFTC’s current position limits regime for certain agricultural commodity contracts. However, the CFTC is proposing to broaden the application of its position limits regime to new market sectors such as energy and metals, and new types of commodity derivatives contracts such as OTC swaps, which will apply new requirements to a tremendous number of market participants (including AGA’s members) that have not previously been subject to any such requirements. Under these circumstances, AGA respectfully submits that the CFTC should take a fresh look to determine whether these requirements, even if they are appropriate for the current limited federal position limits regime, are necessary to achieve the CFTC’s objectives of preventing excessive speculation, are reasonable in scope, and will result in a new regime that, although much larger and broader, still is workable for commercial end-users.

To be sure, AGA appreciates that the CFTC does and will retain ultimate oversight over the proposed process outlined in the Supplemental NOPR. But, to the extent that the requirements imposed upon the Exchanges and market participants are so overly prescriptive and burdensome that the process is determined to be not worth using, then the proposal fails to meet the goals it is meant to achieve.
IV. Conclusion

AGA commends the CFTC for its efforts to provide an alternative process to utilize the expertise and experience of the Exchanges to review and recognize NEBFHs. However, as stated in these comments, AGA respectfully urges the CFTC to make modifications to the proposal when finalized in order to provide regulatory certainty, to reduce duplication of resources at the Exchanges and the CFTC by streamlining its oversight role, and to make the alternate process workable and useable for both the Exchanges and commercial market participants.

Respectfully submitted,

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