

**SECTION-BY-SECTION DESCRIPTION OF
PROPOSED AMENDMENTS TO SECTIONS 151.5 AND 151.10**

CHANGES TO SECTION 151.5

1. **Section (a)(1):** The last sentence of section (a)(1) has been amended to delete the phrase “and the provisions of paragraph (a)(2) of this section have been satisfied.” Section (a)(1) otherwise reflects the Dodd-Frank Act definition of *bona fide* hedge and this amendment deletes the additional qualifications and restores the scope of Congress’ definition.
2. **Section (a)(2):**
 - a. Introductory language is amended to reflect that the examples of “enumerated hedging transactions” are not intended to be exclusive or to otherwise narrow the scope of section (a)(1).
 - b. Section (a)(2)(i) is amended to include certain activities that are included in (a)(1), but were excluded from the original (a)(2), namely anticipated ownership or fixed-price purchase (*see* (a)(1)(iii)(A)) as well as hedges on assets and services (*see* (a)(1)(iii)(A) and (C)). (*See* sections II, III and VI of the attached examples).
 - c. Section (a)(2)(ii) is amended to accomplish the same purposes. In addition, (a)(2)(ii)(C) is amended to include “anticipated merchandising” requirements as provided for in (a)(1)(iii)(A). (*See* section III of the attached examples).
 - d. Section (a)(2)(iii) is amended: (1) to recognize cross-commodity hedging; and (2) to treat as *bona fide* hedges offsetting positions in the same contract month which may be in different classes (*i.e.*, cash-settled vs. physically-settled) and, therefore, would not net as would have futures positions in the same contract month. (*See* section I of the attached examples).
 - e. Sections (a)(2)(i)(B), (a)(2)(iii) and (a)(2)(v) have been amended to delete the prohibition that the positions not be held in the last five days of trading. (*See* section V of the attached examples).
3. **New section (b):** A new section (b) is proposed to track the language in Section 737 of the Dodd-Frank Act (CEA section 4a(a)(7)) to provide that the Commission may allow exemptions from position limits other than for *bona fide* hedging purposes.
4. **Section (c):** Section (b) has been renumbered as section (c). In addition, the language has been modified to require descriptions of activity, as opposed to calling for the submission of data reflecting a “one-for-one” correlation between a physical position and a hedge position. Companies are not managed in this manner and the data could not be collated and provided to the Commission in this way. Finally, section (c) is amended to reflect that information concerning “anticipated” activities would be appropriate to justify a hedge position, in accordance with sections (a)(1) and (a)(2).
5. **New section (d):** A new section (d) has been added to provide feedback to a party that the activity described does or does not fall within the scope of an exemption.

6. **Section (e):** Section (e) has been amended principally to delete the limitation on exemptions for “anticipatory” hedges to one-year. Hedging of physical market activity currently occurs for far greater periods, as reflected by the existence of futures contracts for periods of five years or more.
7. **Section (i), former section (h) and section (j):** The principal changes to these sections are made to streamline the transaction process in connection with the pass-through. The changes: (1) allow for the representation to be made by a trader at the time of the trade, rather than requiring several bilateral communications during an open and, potentially moving, market; (2) limits the need for a representation to the single circumstance where a party seeks to rely on the pass-through exemption (and not, for example, where both parties are hedging physical exposures); and (3) limits the representation that a swap is a hedge transaction to the time that the swap is entered into (eliminating the impractical obligation on the party not relying on the pass-through to track the ongoing character of each swap with each counterparty, and the obligation to notify the counterparty of his activity in the underlying physical market).

CHANGES TO SECTION 151.10

1. **Section (a):** A change is made to provide for notice and comment on the format, coding structure and data transmission procedures required for reports to be submitted to the Commission.
2. **Section (b):** Changes are made to require reports to be filed no later than the fifth day following a trigger, reflecting a party’s need to gather and compile data, as well as the global nature of markets and the multiple time zones in which a firm (particularly one that is aggregating across legal entities) may be trading and holding positions. It also requires monthly, as opposed to daily filings.
3. **New section (c):** A new section (c) has been added to accommodate applications for exemptions under new section 151.5(b).

PART 151—LIMITS ON POSITIONS

Sec. 151.1 Definitions.

151.2 Core referenced futures contracts.

151.3 Referenced contract spot months.

151.4 Position limits for referenced contracts.

151.5 Exemptions for referenced contracts.

151.6 Position visibility.

151.7 Aggregation of positions.

151.8 Foreign boards of trade.

151.9 Preexisting positions.

151.10 Form and manner of reporting and submitting information or filings.

151.11 Registered entity position limits.

151.12 Delegation of authority to the Director of the Division of Market Oversight.

Appendix A to Part 151

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6c, 6f, 6g, 6t, 12a, 19, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

§ 151.5 Exemptions for referenced contracts.

- (a) *Bona fide hedging transactions or positions.*
- (1) Any trader that complies with the requirements of this section may exceed the position limits set forth in § 151.4 to the extent that a transaction or position in a referenced contract:
- (i) Represents a substitute for transactions made or to be made or positions taken or to be taken at a later time in a physical marketing channel;
 - (ii) Is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise; and
 - (iii) Arises from the potential change in the value of—
 - (A) Assets that a person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;
 - (B) Liabilities that a person owns or anticipates incurring; or
 - (C) Services that a person provides or purchases, or anticipates providing or purchasing; or

- (iv) Reduces risks attendant to a position resulting from a swap that—
 - (A) Was executed opposite a counterparty for which the transaction would qualify as a *bona fide* hedging transaction pursuant to paragraph (a)(1)(i) through (a)(1)(iii) of this section; or
 - (B) Meets the requirements of paragraphs (a)(1)(i) through (a)(1)(iii) of this section. Notwithstanding the foregoing, no transactions or positions shall be classified as *bona fide* hedging for purposes of § 151.4 unless such transactions or positions are established and liquidated in an orderly manner in accordance with sound commercial practices ~~and the provisions of paragraph (a)(2) of this section have been satisfied.~~
- (2) *Enumerated Hedging Transactions.* ~~The definition of *bona fide*~~ ***Bona fide*** hedging transactions and positions in paragraph (a)(1) of this section include, **but are not limited to,** the following ~~specific~~ transactions and positions:
 - (i) Sales of ~~any commodity underlying~~ referenced contracts which do not exceed in quantity:
 - (A) Ownership or fixed-price purchase, **or anticipated ownership or fixed-price purchase,** of the contract's underlying cash commodity by the same person; ~~or~~
 - (B) Unsold anticipated production of the same commodity, which may not exceed one year for referenced agricultural contracts, by the same person ~~provided that no such position is maintained in any referenced contract during the five last trading days of that referenced contract.~~
 - (C) **The value of any asset owned or purchased pursuant to a fixed-price contract, or anticipated to be owned or purchased pursuant to a fixed-price contract by a producer, processor, commercial user, or merchant for purposes related to its business as such; or**
 - (D) **The value of any service, the rights to which are held or anticipated to be held by a producer, processor, commercial user, or merchant in connection with its business as such.**

- (ii) Purchases of referenced contracts which do not exceed in quantity:
- (A) The fixed-price sale, **or anticipated fixed price sale,** of the contract's underlying cash commodity by the same person;
 - (B) The quantity equivalent of ~~fixed price~~ **fixed price sales, or anticipated fixed price sales** of the cash products and byproducts of such commodity by the same person; ~~or~~
 - (C) Unfilled anticipated requirements of the same cash commodity, ~~which may not exceed one year for referenced agricultural contracts, for processing, manufacturing, merchandizing,~~ or feeding by the same person, provided that such transactions and positions in the five last trading days of any referenced contract do not exceed the person's unfilled anticipated requirements of the same cash commodity for that month and the next succeeding month;
 - (D) The value of any asset sold pursuant to a fixed-price contract, or anticipated to be sold pursuant to a fixed-price contract by a producer, processor, commercial user, or merchant for purposes related to its business as such; or**
 - (E) The value of any service which is provided or is anticipated to be provided by a producer, processor, commercial user, or merchant for purposes related to its business as such.**
- (iii) Offsetting sales and purchases in referenced contracts which do not exceed in quantity that amount of the same cash commodity **(or in another commodity provided that the fluctuations in value of the position in the first commodity are substantially related to the fluctuations in value of the other commodity)** which has been bought and sold by the same person at unfixed prices ~~basis different delivery months of the referenced contract, provided that no such position is maintained during the five last trading days of any referenced contract.~~
- (iv) Purchases or sales by an agent who does not own or has not contracted to sell or purchase the offsetting cash commodity at a fixed price, *provided that* the person is responsible for the merchandising of the cash positions which is being offset and the agent has a contractual arrangement with the person who owns the commodity or holds the cash market commitment being offset.

- (v) Sales and purchases in referenced contracts described in paragraphs (a)(2)(i), (a)(2)(ii), (a)(2)(iii), and (a)(2)(iv) of this section may also be offset other than by the same quantity of the same cash commodity, *provided that* the fluctuations in value of the position in referenced contracts are substantially related to the fluctuations in value of the actual or anticipated cash position, ~~and provided that the positions shall not be maintained during the five last trading days of any referenced contract.~~

(b) Other Exemptions. Upon specific request made in accordance with section 151.10(c), the Commission may exempt, conditionally or unconditionally, any person or class of persons, any swap or class of swaps, any contract of sale of a commodity for future delivery or class of such contracts, any option or class of options, or any transaction or class of transactions from any requirements of part 151 of these regulations.

(b)(c) *Information on cash market commodity activities.* Any trader with a position that exceeds the position limits set forth in **§section** 151.4 pursuant to paragraph (a) of this ~~section~~**Section** shall submit to the Commission a 404 filing, in the form and manner provided for in **§section** 151.10, containing the following information with respect to such position:

- (1) ~~The~~**A description of the** cash market commodity **and activity being** hedged, the units in which it is measured, and the corresponding referenced contract that is used for hedging the cash market commodity;
- (2) ~~The number~~**Information sufficient to describe how the purchases and/or sales** of referenced contracts ~~used for hedging~~**are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise and otherwise in accordance with section 151.5(a)(1);**
- (3) The entire quantity of stocks owned **or anticipated to be owned** of the cash market commodity that is being hedged by a position in a referenced contract;
- (4) The entire quantity of open fixed price purchase commitments **or anticipated fixed-price purchase commitments** in the hedged commodity outside of the spot month of the corresponding referenced contract;
- (5) The entire quantity of open fixed price purchase commitments **or anticipated fixed-price purchase commitments** in the hedged commodity in the spot month of the corresponding referenced contract;

- (6) The entire quantity of open fixed price sale commitments **or anticipated fixed-price sale commitments** in the hedged commodity outside of the spot month of the corresponding referenced contract; ~~and~~
- (7) The entire quantity of open fixed price sale commitments **or anticipated fixed-price sale commitments** in the hedged commodity in the spot month of the corresponding referenced contract; ~~and~~

(d) Notice of Disallowance. If the Commission determines that all or a portion of the transactions and positions in the referenced contracts that are the subject of the Form 404 filing do not satisfy the requirements of paragraph (a) or the terms of the exemption in paragraph (b) of this section, the Commission shall notify the trader within 20 days after the Commission has furnished the information required under paragraphs (b) and (c) of this section.

(ee) Anticipatory hedge exemptions.

- (1) *Initial statement.* Any trader who wishes to exceed the position limits set forth in § 151.4 pursuant to paragraph (a) of this section in order to hedge unsold anticipated commercial production or unfilled anticipated commercial requirements connected to a commodity underlying a referenced contract, shall submit to the Commission a 404A filing at least ten days in advance of the date that such transactions or positions would be in excess of the position limits set forth in § 151.4. The 404A filing shall be made in the form and manner provided in § 151.10 and shall contain the following information with respect to such position:
 - (i) The cash market commodity and units for which the anticipated production or requirements pertain;
 - (ii) The dates for the beginning and end of the period for which the person claims the anticipatory hedge exemption is required, ~~which may not exceed one year;~~
 - (iii) The production or requirement of that cash market commodity for the three complete fiscal years preceding the current fiscal year;
 - (iv) The anticipated production or requirements for the period hedged, ~~which may not exceed one year;~~
 - (v) The unsold anticipated production or unfilled anticipated requirements across the period hedged, ~~which may not exceed one year;~~
 - (vi) The referenced contract(s) that the trader ~~will~~**expects to** use to hedge the unfilled, anticipated production or requirements; and

- (vii) The number of referenced contracts that ~~will~~ **is expected to** be used for hedging.
- (2) *Approval.* All or a specified portion of the unsold anticipated production or unfilled anticipated requirements described in these filings shall not be considered as offsetting positions for *bona fide* hedging transactions or positions if such person is so notified by the Commission within ten days after the Commission is furnished with the information required under this paragraph (c).
- (i) The Commission may request the person so notified to file specific additional information with the Commission to support a determination that the statement filed accurately reflects unsold anticipated production or unfilled anticipated requirements.
 - (ii) The Commission shall consider all additional information filed and, by notice to such person, shall specify its determination as to what portion of the production or requirements described constitutes unsold anticipated production or unfilled anticipated requirements for the purposes of *bona fide* hedging.
- (3) *Supplemental reports.* Whenever the sales or purchases which a person wishes to consider as *bona fide* hedging of unsold anticipated production or unfilled anticipated requirements shall exceed the amounts in the most recent filing or the amounts determined by the Commission to constitute unsold anticipated production or unfilled anticipated requirements pursuant to paragraph (c)(2) of this section, such person shall file with the Commission a statement which updates the information provided in the person's most recent filing, and for instances anticipated needs exceed the amounts in the most recent filing, at least ten days in advance of the date that person wishes to exceed these amounts.
- (~~e~~f) *Additional information from swap counterparties to bona fide hedging transactions.* All persons that ~~enter into swap transactions or maintain swap positions pursuant to~~ **in excess of the limits set forth in 151.4 in reliance upon the exemption set forth in** paragraph (a)(1)(iv) of this section shall also submit to the Commission a 404S filing not later than 9:00 a.m. **Eastern Time** on the **5th** business day following that to which the information pertains. The 404S filing shall be done in the form and manner provided for in § 151.10 and shall contain the following information:
- (1) The commodity reference price for the swaps that would qualify as a *bona fide* hedging transaction or position;

- (2) The entire gross long and gross short quantity underlying the swaps that were executed in a transaction that would qualify as a *bona fide* hedging transaction, and the units in which the quantity is measured;
 - (3) The referenced contract that is used to offset the exposure obtained from the *bona fide* hedging transaction or position of the counterparty;
 - (4) The gross long or gross short size of the position used to offset the exposure obtained from a *bona fide* hedging transaction or position of the counterparty;
 - (5) The gross long or gross short size of the position used to offset the exposure obtained from a *bona fide* hedging swap transaction or position that is in the spot month.
- (eg) *Recordkeeping.* Traders who qualify for *bona fide* hedge exemptions for cash market positions, anticipatory hedging, and swaps opposite counterparties that would qualify as *bona fide* hedging transactions or positions shall maintain complete books and records concerning all of their related cash, futures, and swap positions and transactions and make such books and records, along with a list of swap counterparties, available to the Commission upon request.
- (fh) *Conversion methodology for swaps not involving the same commodity.* In addition to the information required under this section, traders engaged in the hedging of commercial activity or positions resulting from swaps that are used for the hedging of commercial activity that does not involve the same quantity or commodity as the quantity or commodity associated with positions in referenced contracts that are used to hedge shall submit to the Commission a 404, 404A, or 404S filing, as appropriate, containing the following information:
- (1) Conversion information both in terms of the actual quantity and commodity used in the trader's normal course of business and in terms of the referenced contracts that are sold or purchased; and
 - (2) An explanation of the methodology used for determining the ratio of conversion between the actual or anticipated cash positions and the trader's positions in referenced contracts.
- (gi) *Requirements for bona fide hedging swap counterparties.* ~~Upon entering into a swap transaction where at least one party is relying on a *bona fide* hedge exemption~~ **A party seeking to rely upon section 151.5(a)(1)(iv)(A)** to exceed the position limits of § 151.4 with respect to such a swap:
- (1) ~~The party not hedging a cash market commodity risk, or both parties to the swap if both parties are hedging a cash market commodity risk, shall:~~

- ~~(i) — Ask for a written representation from its counterparty verifying that **may only do so if its counterparty provides a representation that, as to such counterparty,** the swap qualifies as a *bona fide* hedging transaction under paragraph (a)(1)(iv) of this section; and~~
- ~~(ii) — Upon receipt of such written representation from the counterparty, provide written confirmation of such receipt to the counterparty.~~
- ~~(2) — The party relying on the *bona fide* hedging exemption to enter into the swap transaction shall submit a written representation to its counterparty verifying that the swap qualifies as a *bona fide* hedging transaction, as defined in paragraph (a)(1)(iv) of this section.~~
- ~~(h) — The written representation and receipt confirmation described in paragraph (g) of this section shall be retained by the parties to the swap and provided to the Commission upon request. (i) *Filing requirement for bona fide hedgers.* Any party with cash market commodity risk relying on a *bona fide* hedging exemption to enter into and maintain a referenced contract position shall submit to the Commission a 404S filing, in the form and manner provided for in § 151.10, containing the information in paragraphs (b) and (c) of this section, for each business day on which such position was maintained, up to and including the day after the trader's position level is below the position limit that was exceeded **at the time that the swap is entered into.**~~
- ~~(j) *Positions that are maintained.* For a swap that satisfies the requirements of paragraph (a) of this section, the party to whom the cash market commodity risk is transferred may itself establish, lift and re-establish a position in excess of the position limits of § 151.4 provided that:—(1) ~~The **the** party and its counterparty comply with the requirements of paragraphs (g) through (i) of this section; and~~ (2) ~~The party may only exceed such position limit to the extent and in such amounts that the qualifying swap directly offsets, and continues to offset, the cash market commodity risk of a *bona fide* hedging counterparty.~~~~

§ 151.10 Form and manner of reporting and submitting information or filings.

Unless otherwise instructed by the Commission or its designees, any person submitting reports under this section shall submit the corresponding required filings and any other information required under this part to the Commission as follows:

- (a) Using the format, coding structure, and electronic data transmission procedures approved in writing by the Commission **after written notice and opportunity for comment;** and
- (b) Not later than 9 a.m. **Eastern Time** on the next**fifth** business day following the reporting or filing obligation is incurred *unless*:

- (1) A 404A filing is submitted pursuant § 151.5(c), in which case the filing must be submitted at least ten days in advance of the date that transactions and positions would be established that would exceed a position limit set forth in § 151.4;
 - (2) A 404 or 404S filing is submitted pursuant to § 151.5, in which case the filing must be submitted **no later than the fifth business** day after a position limit is exceeded and ~~all days the trader exceeds such levels and the first day after~~ **monthly thereafter for any month in which** the trader's position is ~~below~~ **exceeds** the position limit;
 - (3) The filing is submitted pursuant to § 151.6 and not under any other part under this title, then the 401, 402S, 404, or 404A filing, or their respective substitutes as provided for under § 151.6(c)(5) and (d), shall be submitted after the establishment of a position exceeding a visibility level on the latter of either (i) 9 a.m. Eastern Time five business day after such time or (ii) 9 a.m. the first business day of the subsequent calendar month. If the filing is submitted pursuant to § 151.6 and not under any other part under this title, the filing trader shall be required to submit a 401, 402S, 404, or 404A filing, or their respective substitutes, no more often than once per calendar month; or
 - (4) An application for exemption renewal is filed pursuant to § 151.7(g)(1), in which case the filing shall be submitted within 30 calendar days of January 1 of each year following the initial application for exemption.
- (c) an application for an exemption under section 151.5(b) shall be submitted in the form and in the manner as required by the Commission.

ATTACHMENT A

EXAMPLES OF TRANSACTIONS THAT DO NOT QUALIFY AS BONA FIDE HEDGING UNDER THE PROPOSED POSITION LIMITS RULE

The following provides examples of hedging transactions commonly entered into by commercial firms in agricultural and exempt commodity markets that will be effectively excluded from the definition of *bona fide* hedge as set forth under the Commission's Proposed Position Limits Rule.

I. UNFIXED PRICE COMMITMENTS.

A. IN THE SAME CALENDAR MONTH.

Proposed CFTC Rule 151.5(a)(2)(iii) would permit a hedge of offsetting unfixed price purchase and sale commitments only if they were based on different delivery months. The following example demonstrates the potential need to hedge basis risk in the same delivery month, but at a different delivery location. If one used a cash-settled swap in one location and a physical delivery futures contract at the other, these positions would not offset, and would not qualify as *bona fide* hedge positions.

Example: A natural gas ("NG") wholesaler buys gas at (Point 1) and sells it at another point on the same pipeline (Point 2) to a different counterparty. Both contracts are at an index price plus or minus a differential. In order to lock in the current spread relationship between the prices at the two delivery locations, NG wholesaler sells a NYMEX Henry Hub futures contract and enters into a "long" swap on the price at Point 2, hedging the risk that the price at Point 2 will decline relative to the price at Point 1. Since the purchase and sale will occur during the same delivery month, this hedge would not constitute a bona fide hedge under proposed CFTC Rule 151.5(a)(2).

B. IN A DIFFERENT COMMODITY.

Proposed CFTC Rule 151.5(a)(2)(iii) would permit a hedge of offsetting unfixed price purchase and sale commitments only if they were in the same commodity. The following example demonstrates the potential need to hedge basis risk between two different commodities.

Example 1: Power plant operator buys natural gas from which it generates and sells power. It buys gas from one party at an index plus or minus a differential and it sells power to a different party at an index plus or minus a differential. In order to lock in the basis between gas and power prices, it enters into a swap on the power price and Henry Hub futures contracts in natural gas, effectively hedging the risk that the price of power will decline relative to the price of gas. Since the two prices are referencing different commodities, this hedge would not constitute a bona fide hedge under proposed CFTC Rule 151.5(a)(2).

II. “ANTICIPATED” TRANSACTIONS.

Although hedges of “anticipated ownership” and “anticipated merchandising” transactions would be *bona fide* hedges under the language in the Dodd-Frank Act and seemingly under proposed CFTC Rule 151.5(a)(1), they would not be treated as such because there is no provision for them as “enumerated hedges” under proposed CFTC Rule 151.5(a)(2).

Example 1: Commercial entity X, a wholesale marketer of crude oil, has purchased a cargo of oil currently transiting the Atlantic from Europe to the US at the price of ICE Brent futures plus or minus a differential. It is negotiating to sell that cargo in the U.S. gulf coast at a price of NYMEX WTI plus or minus a differential. Although it has not concluded negotiations on the sale, it believes that it will do so in the next several days. Believing that prices may fall over the next several days, it places a hedge in NYMEX WTI futures. Under proposed CFTC Rule 151.5(a)(2), this would not constitute a *bona fide* hedge.

Example 2: In the example above, the parties have concluded their negotiations and, as is standard in the industry, agreed to the transactions subject to credit terms and legal review of documentation. Again, the NYMEX WTI hedge placed by Commercial entity X would not constitute a *bona fide* hedge under the proposed CFC Rule 151.5(a)(2).

Example 3: Farmers Elevator, a grain merchandiser, owns a 3 million bushel storage facility in Farmville, a town surrounded by thousands of acres of growing corn, soybeans, and wheat. As part of its normal business practices, Farmers Elevator expects in the future to enter into forward contracts with area farmers under which Farmers Elevator agrees to pay farmers a fixed price for their grain at harvest. In order to hedge this risk, Farmers Elevator “goes short” on CME by selling futures contracts. Under the proposed rule, this would not constitute a *bona fide* hedge since at the time of the futures position by Farmers Elevator there in fact is no underlying physical contract. The result would be that Farmers Elevator may no longer be able to provide attractive forward cash market contracts to its farm customers.

Example 4: In February of 2011, prior to spring wheat planting, Elevator X, which has storage capacity that is currently sitting completely empty, locks in a spread of \$1.40 on a portion of its expected throughput for the crop year by buying July 2011 Wheat futures and selling July 2012 Wheat futures. Regardless of whether Elevator X actually buys wheat in 2011, this transaction represents a hedge by Elevator X of its capacity (i.e., the value of its grain storage assets). If there is a crop failure during the 2011 harvest resulting in little to no wheat deliveries at Elevator X, the spread position hedge will perform by providing Elevator X the economic value of the position hedging against such an event. Alternatively if Elevator X (as expected) buys wheat, it will hedge these specific price risks by taking appropriate futures positions and reducing the July/July Wheat spread. This “hedging of capacity” strategy would not be a *bona fide* hedge under the proposed CFTC proposed Rule 151.5(a)(2).

III. HEDGING OF SERVICES.

Although hedges on the value of “services that a person provides or purchases, or anticipates providing or purchasing” would be *bona fide* hedges under the language in the Dodd-Frank Act and seemingly under proposed CFTC Rule 151.5(a)(1), they would not be treated as such because there is no provision for them as “enumerated hedges” under proposed CFTC Rule 151.5(a)(2).

Example 1: Commercial energy firm Z is a wholesale marketer of natural gas. It has an opportunity to acquire one year of firm transportation on Natural Gas Pipeline (“NGPL”) from the Texok receipt point to the Henry Hub delivery point for an all-in cost of \$.30/mmbtu. The “value” of that service at that time is \$.33/mmbtu, measured as the difference between the price at which one can sell the natural gas at the delivery point minus the price at which one can purchase the gas at the receipt point. At that time, commercial energy firm Z can enter into a swap locking in the calendar 2012 strip at Texok at a price of \$4.00/mmbtu and sell a calendar strip of NYMEX Henry Hub natural gas futures contracts locking in a sale price at a weighted average of \$4.33/mmbtu. Entering into those two separate transactions without having actually purchased or sold natural gas to transport has allowed commercial energy firm Z to hedge the value of the firm transportation service that it holds or can acquire.¹ However, under the Commission’s proposal, the transactions would not qualify as *bona fide* hedge transactions.

Example 2: Natural Gas Producer X has new production coming on line over the next few years in the Gulf of Mexico. The production is located near Point A on Pipeline Y’s interstate natural gas pipeline system. Producer X has the desire to sell gas to customers in Region B as the price for natural gas in Region B is significantly higher than at Point A, where natural gas would currently be delivered into Pipeline Y’s system. Producer X contacts Pipeline Y and negotiates a Precedent Agreement with the pipeline under which Pipeline Y will build new transportation capacity from Point A to Region B. Under the Precedent Agreement, Producer A is obligated to pay demand charges to the pipeline for a term of 5 years from the date the pipeline goes into commercial operation, if Pipeline Y is able to complete a successful open season and obtains the necessary permits to construct and operate the new section or expansion of its pipeline system from Point A to Region B. The open season is designed to attract commitments from other potential shippers to help support the cost of building and operating the pipeline expansion. The schedule calls for a completion of construction and commercial operation of the pipeline expansion on March 31, 2013.

Producer X is concerned that the natural gas price differential between Point A and Region B could collapse and is fairly confident the expansion project will be completed. In order to manage the risk associated with the 5-year financial commitment to Pipeline Y, i.e., pipeline demand charges, Producer X

¹ Note that this “value” exists whether commercial energy firm Z ever owns or intends to own the physical commodity. In some circumstances, the firm might choose to release the capacity to a third-party and realize the value of the transportation service from the capacity release transaction.

enters into swaps at Point B for a term of April 1, 2013 to March 31, 2018, to lock-in the price spread between Point A and Region B. Under the Commission's Proposed Rule, the swap transactions would not qualify as bona fide hedges. In this case, the expansion of the pipeline system that would afford customers in Region B more access to lower priced gas might not occur without the ability to count the swaps associated with this transaction as a bona fide hedge.

Example 3: Commercial energy firm A is an electric utility that owns coal-fired generation facilities. Firm A enters into contracts with major railroads to transport coal from producing regions to its various generating facilities. One or more of these contracts are subject to a fuel surcharge, whereby rates paid by firm A to transport coal are indexed to the price of diesel fuel. As prices for the diesel fuel rise, the rate paid by firm A to transport coal also rises. To mitigate this risk, firm A could enter into a long position in futures contracts or swaps for the diesel fuel, whereby gains realized on these instruments should prices rise would off-set any increase in the rate paid by firm A to transport coal. Under the Proposed Rule, however, these transactions would not qualify as bona fide hedge transactions since they would be entered into as a hedge of services — in this case, coal transportation services.

IV. HEDGES OF "SPREAD" OR "ARBITRAGE" POSITIONS.

Although hedges on the value of spread or arbitrage positions would be *bona fide* hedges under the language in the Act and seemingly under proposed CFTC Rule 151.5(a)(1), they would not be treated as such because there is no provision for them as "enumerated hedges" under proposed CFTC Rule 151.5(a)(2).

Example 1: The business model of Company X is to import crude oil from Europe to the United States. On an average year it imports 48 million barrels of crude oil. Its purchases in Europe are generally priced against Brent oil and its sales in the United States are priced against WTI. Those prices are readily available across the price curve, more than a year in advance. There are times when Company X believes the differential for a particular month is favorable and it seeks to lock in that differential by buying Brent swaps and selling NYMEX WTI futures, knowing that it will ultimately buy the oil priced in Brent and sell the oil priced in WTI. Under the proposed rule, even though this transaction allows Company X to hedge the risk of its business strategy and expected transactions, this would not be a bona fide hedge under proposed CFTC Rule 151.5(a)(1).

Example 2: Grain Merchandiser X is in the business of buying wheat in, among other places, North Dakota, using a Minneapolis Grain Exchange (MGEX) reference price. Grain Merchandiser X is also in the business of selling wheat to Italian flour mills, using a Euronext France (MATIF) price. These prices are readily available across the price curve, more than a year in advance. As such, there are times when Grain Merchandiser X believes the differential for a particular month is favorable and it seeks to lock in the differential by selling MATIF futures (or swaps) and buying MGEX futures, even though it will ultimately buy North Dakota wheat priced in MGEX futures. This transaction, which allows Grain Merchandiser X to hedge the risk of the expected

transactions in its business strategy, would not be a *bona fide* hedge since it is not enumerated under proposed CFTC Rule 151.5(a)(2).

V. HEDGING IN THE LAST FIVE DAYS OF TRADING AN EXPIRING CONTRACT.

The following examples illustrate the uneconomic consequences of prohibiting a *bona fide* hedge positions from being held in the last five days of trading.

A. UNSOLD ANTICIPATED PRODUCTION – Proposed CFTC Rule 151.5(a)(2)(i)(B)

Example 1: Company A anticipates producing 2000 barrels of crude oil in July. That production is currently unsold. To hedge its risk that the value of those barrels may decline prior to their sale, Company A will sell 2 July NYMEX WTI crude oil futures contracts, which represent delivery ratably during the month of July. The last trading day of the July futures contract is June 21st. The last day that Company A could hold the position as a *bona fide* hedge under the proposal is June 14th. This means that if Company A holds the contract from June 15th through June 21st and delivers its oil under the July futures contract, it could not treat those positions as a *bona fide* hedge during that period. Alternatively, in order to maintain *bona fide* hedge status, it would be required to roll its hedge into the August contract on June 14th, taking basis risk on the July/August spread for the additional 5 days.

B. UNFIXED PRICE CONTRACTS – Proposed CFTC Rule 151.5(a)(2)(iii)

Example 1: Company B has a contract to buy natural gas at the Henry Hub in July at NYMEX + \$.10 and a contract to resell it at the Henry Hub in August at NYMEX + \$.15. To hedge the basis risk, it sells NYMEX July futures and buys NYMEX August futures. Under the Commission's proposal, this position would not be a *bona fide* hedge if it was carried into the last five days of trading of the NYMEX July futures contract. Company B would be forced to roll its position to a less efficient hedge.

C. CROSS-COMMODITY HEDGES – Proposed CFTC Rule 151.5(a)(2)(v)

Example 1: Commercial energy firm J supplies jet fuel to airlines at a variety of airports in the United States, including Houston Intercontinental Airport. It has a fixed-price contract to purchase jet fuel from a refinery on the gulf coast during early June. Because there is no liquid jet fuel futures contract, commercial energy firm J uses the June NYMEX physically-delivered WTI crude oil futures contract to hedge its price risk. Under the Proposed Rule, commercial energy firm J would be required to liquidate its hedge during the last five trading days of the June contract and either remain unhedged or replace its June hedge with a contract that represents a different delivery period and, therefore, a different supply/demand and pricing profile.

Example 2: AgriCorp, a grain warehouse, grain merchandiser and feed ingredient wholesaler, buys wheat from farmers. At the same time, AgriCorp enters into a fixed price agreement with a feedyard to supply feed (the exact components of which could be satisfied using wheat, corn, DDGs, or other ingredients). In order to hedge its risk, AgriCorp enters into a swap, hedging the

risk that the price of wheat will decline relative to the price of corn (the corn futures price better correlates to feed prices, thereby providing a more effective hedge). Since the two prices are referencing different commodities, this hedge would not constitute a bona fide hedge if held in the last five days of trading.

VI. HEDGES ON ASSETS.

Example: XYZ Corp. is planning on buying a liquefied natural gas (“LNG”) vessel. The value of that asset is based upon the spread between natural gas prices between and among various continents. XYZ will need financing in order to make the purchase. The lenders will only make a loan if XYZ can demonstrate a level of certainty as to its future revenue stream. As it negotiates with the shipbuilder and as it negotiates with lenders, the current differentials are favorable for robust demand for LNG. XYZ wants to enter into separate swaps and/or futures positions in the US, Europe and Asia to lock in the potential purchase prices in producing regions and the potential sales prices in consuming regions at current differentials. This will allow it to lock in the value of LNG transportation and satisfy lenders that this is a good credit risk for them to take on. Those swaps and/or futures positions would not be bona fide hedges under the Proposed Position Limit Rule because the ship-owner does not own or anticipate owning the underlying commodities.