

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

ENERGY AND ENVIRONMENTAL MARKETS ADVISORY
COMMITTEE MEETING

Washington, D.C.

Wednesday, July 29, 2015

1 PARTICIPANTS:

2 Opening Remarks:

3 CHAIRMAN TIMOTHY MASSAD

4 COMMISSIONER MARK WETJEN

5 COMMISSIONER SHARON BOWEN

6 COMMISSIONER CHRISTOPHER GIANCARLO

7 Panel I: How Can Exchanges Help Implement Federal
8 Position Limits?

9 ERIK HAAS, ICE Futures U.S.

10 TOM LaSALA, CME

11 RON OPPENHEIMER, Commercial Energy Working
12 Group

13 Panel II: A Phased Approach to Position Limits:

14 STEPHEN BERGER, Managed Funds Association
15 Y.J. BOURGEOIS, Natural Gas Supply
16 Association

17 WILLIAM McCOY, FIA

18 Panel II: Trade Options and Forwards with
19 Embedded Volumetric Optionality - Where Do We
20 Stand?

21 PAUL HUGHES, Southern Company

22 ARUSHI SHARMA-FRANK, Electric Power Supply
Association

AMY FISHER, GE Energy Financial Services,
Inc., on behalf of Cogen Technologies
Linden Venture, L.P.

1 PARTICIPANTS (CONT'D):

2 Other Participants:

3 JOSEPH ALLEN
4 Caterpillar Inc.5 JAMES ALLISON
6 ConocoPhillips7 JIM CATER
8 American Public Power Association9 MICHAEL COSGROVE
10 Vectra Capital11 ROB CREAMER
12 FIA Principal Traders Group13 TODD CREEK
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16 CME Group17 MICHAEL GILL
18 Independent Petroleum Association19 PAUL HUGHES
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American Gas Association

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1 P R O C E E D I N G S

2 (10:02 a.m.)

3 COMMISSIONER GIANCARLO: Why don't we
4 all start grabbing our seats and getting set.
5 Apparently there are some problems on the Metro
6 today, there's, I gather, a train stuck in the
7 underground, so some folks may be on that and may
8 be coming in late, but I think we'll get started
9 nevertheless.

10 I thank everybody for coming today; and
11 certainly thank our panelists for being here.
12 I'll start with a few remarks and then hand over
13 to my fellow Commissioners, but before I do, is
14 there any housekeeping business that we -- just in
15 terms of calling the meeting to order, or anything
16 on the agenda that we need to --

17 SPEAKER: No.

18 COMMISSIONER GIANCARLO: No?

19 SPEAKER: You've just done it.

20 COMMISSIONER GIANCARLO: Okay. Welcome
21 to the Second Meeting of the CFTC's Reconstituted
22 Energy and Environmental Markets Advisory

1 Committee.

2 And I'd like to welcome four new
3 Associate Members to the Committee and to today's
4 meeting. William Jones, CEO of Jones Petroleum
5 and JP Capital & Insurance from Jackson, Georgia.
6 Thanks for being with us, Bill.

7 Martin Bates, President of Strategy,
8 Energy & Development, Alcoa, from Pittsburgh,
9 Pennsylvania; and Michael Padgett is in his place.
10 Thank you, Michael, for being here.

11 Joseph Allen, Director of Energy Policy
12 for Caterpillar and Solar Turbines; fulfilling our
13 environmental portion of our mandate. Thank you
14 for being here.

15 And Andrew Soto, the Vice President for
16 Regulatory Affairs with the American Gas
17 Association. Thank you for joining the Committee
18 and for supporting its important work.

19 In February, the Committee met and
20 focused on the CFTC's proposed rules to impose,
21 for the first time, Federal Position Limits on
22 American energy and environmental markets. That

1 meeting identified several areas where the current
2 Position Limits Proposal would be problematic.

3 One, the proposed limitation on the bona
4 fide hedging exemption to only a limited number of
5 enumerated hedges leaves many other strategies,
6 including bread-and-butter energy risk management
7 strategies ineligible for the bona fide hedging
8 exemption.

9 And also, secondly, the increasing
10 evidence of a distinct lack of liquidity and
11 widening bid-ask spreads further out the curve,
12 perhaps resulting from, some participants noted,
13 insufficient speculation, that the CFTC's Position
14 Limits Proposal would exacerbate.

15 In my mind we must find an approach that
16 addresses these problematic aspects of the
17 proposed rule so that U.S. Market participants
18 may continue to manage the risk associated with
19 their production and price.

20 Along these lines, I had the privilege
21 last week to spend, in the Midwest, meeting with
22 many agricultural producers, such as dairymen,

1 pork producers and row crop farmers. And the
2 number one concern of producers of corn, soybeans,
3 pork and dairy is what price will they get paid
4 for their product come harvest time?

5 The spot price they are paid for these
6 commodities is what puts food on their tables, and
7 pays for their kids' school supplies come the
8 fall. So you can understand their worries this
9 summer over the current tumbling in worldwide
10 commodity prices that has been widely reported in
11 the financial press.

12 These falling prices led me to ask the
13 CFTC's Office of the Chief Economist for some
14 basic data covering the 28 commodities covered by
15 our position limits proposal. And the information
16 they provided me was stark. Across the 28
17 commodities that will be covered by the proposed
18 Position Limits Rule, there has been a dramatic
19 double-digit decrease in prices since December
20 2010. In fact, since the year that the Dodd-Frank
21 Act was signed into law, there has been a 42.6
22 percent decline in the 22 commodities covered by

1 the Bloomberg Investable Commodity Index.

2 It was apparent from my meetings in
3 Iowa, in Minnesota, in Illinois, that many
4 American agricultural producers have reduced their
5 hedging activity in the past few years, making
6 them more vulnerable to these types of volatile
7 price swings in U.S. commodity markets. If and
8 when the Commission moves forward with a position
9 limits regime, we must be absolutely certain that
10 we do not make it more difficult for American
11 agricultural and energy producers to protect
12 themselves against huge declines in commodity
13 prices because of wooden or inflexible rules.

14 If the current collapse in world
15 commodity prices continues and the Position Limits
16 Rules are not made more workable, we may be
17 imposing burdens on hedging risk at precisely the
18 wrong time. I trust this Commission has that
19 concern and foresight to avoid such a result.

20 Now, let me briefly highlight what the
21 EEMAC will cover at today's meeting. The first
22 panel will consider a framework for a CFTC

1 authorization of the exchanges to grant bona fide
2 hedging exemptions for legitimate risk reducing
3 strategies. This approach was recently commended
4 by Chairman Massad. The major commodities
5 exchanges, some EEMAC members and the CFTC staff
6 have all expressed some interest as well.

7 So the first panel will discuss a
8 minimum framework for providing discretion to the
9 exchanges and SEFs to review and approve, where
10 appropriate, non-enumerated hedging exemptions
11 from Federal position limits. Of course, this
12 authority would remain subject to CFTC oversight.

13 Yet, handled properly, this has the
14 potential to make the current proposal more
15 workable, which many commentators have said is
16 needed. In addition, the first panel will explore
17 the possibility that exchanges can administer a
18 position accountability regime as a way to soften
19 the impact of declining liquidity outside of the
20 spot month.

21 Our second panel will examine the
22 possibility of adopting a phased Federal Position

1 Limits Rulemaking that would begin by covering the
2 spot month before turning to rules for the other
3 months. This approach would avoid exacerbating
4 the present liquidity problems outside the spot
5 month that were identified in the February EEMAC
6 meeting.

7 It would give all market participants
8 the opportunity to adjust to the new process of
9 tracking and reporting commodity swaps along with
10 their futures and options. It would also provide
11 the CFTC with additional time to obtain better
12 data about the over-the-counter market for
13 physical commodities before setting rules for
14 later implementation.

15 I note that the CFTC has had good
16 success with phased rulemaking, most recently with
17 its phased approach to implementation of the swaps
18 clearing mandate. I hope to learn of any reason
19 why a similarly phased rulemaking would not be
20 similarly successful in the case of position
21 limits.

22 Our third and final panel will consider

1 trade options and forward contracts with embedded
2 volumetric optionality. As most of you know, the
3 CFTC has started taking action to strike the right
4 balance in its regulation of these very important
5 transactions.

6 We recently finalized a revised
7 implementation of our 7-part test for EVOs to
8 provide market participants certainty on whether
9 their physically settled, often long-term
10 contracts must nonetheless be treated as swaps
11 because they contain embedded volumetric
12 optionality. So the third panel will provide us
13 with an update on the degree to which the recent
14 actions have resulted -- the recent actions by the
15 CFTC have resulted in the intended regulatory
16 certainty.

17 In addition, we will consider whether
18 there is more the CFTC can do to ensure that these
19 vital transactions are not subject to burdensome
20 regulatory requirements.

21 With that, I thank you all, and I thank
22 the witnesses who have prepared thoughtful

1 presentations. And I thank the CFTC staff for
2 working so hard to arrange this meeting.

3 And finally I want to recognize
4 Committee Member Michael Cosgrove, who has
5 graciously agreed to Chair today's meeting. Thank
6 you, Michael. And I now turn to Chairman Massad
7 and my fellow Commissioners to make their opening
8 remarks.

9 CHAIRMAN MASSAD: Thank you, Chris.
10 First of all, welcome everyone. It's great to see
11 all of you. We really appreciate the time you've
12 taken to be here, and to participate in this.
13 These discussions are always very beneficial. I
14 want to thank in particular those people making
15 presentations, because obviously you've taken the
16 time to prepare those, and put a lot of thought
17 into it, and we appreciate that very much.

18 I want to thank Commissioner Giancarlo
19 for organizing this and his staff in particular
20 for all the work that they've put into it, and the
21 rest of our staff for facilitating the event.

22 I'm going to be very brief. I look

1 forward very much to today's discussion on the
2 Position Limits Rule. Generally we've obviously
3 taken a lot of comments. We've reopened the
4 comment period a number of times, we are digesting
5 all those comments and, you know, I think all of
6 us take these issues very seriously and want to
7 come out with a rule that addresses the
8 congressional mandate of reducing the risk of
9 excessive speculation while at the same enabling
10 commercial participants to hedge effectively.

11 On the non-enumerated hedges point, yes,
12 I have noted that I am willing to look at this
13 issue, so I'll be interested in what participants
14 have to say. Let me just say, if we were to
15 decide to go down this road, then I would expect
16 us to come up with a proposal and solicit public
17 comment on that, so as to give everyone, not just
18 those people in this room, an opportunity to
19 comment.

20 On the trade option and EVO issue, as
21 Commissioner Giancarlo noted, we have taken action
22 on EVO, we have a proposal out there on trade

1 options, and the comment period I think is closed
2 on that. I would hope that we can move forward on
3 that soon.

4 Finally, I did note Commissioner
5 Giancarlo's statement on prices in the Fall, in
6 commodity prices, and I share his concern, or his
7 recognition of the concern of many members of the
8 agricultural community on that. And I agree with
9 him that that does make it important that that
10 they can hedge effectively.

11 I did note also his reference to the
12 fact that the decline in prices has been since the
13 passage of Dodd-Frank. Actually, if you look at
14 the data, in a lot of commodities prices went up
15 after the passage of Dodd-Frank, and then came
16 down later. I know Chris is very well capable of
17 distinguishing causation from correlation, so I
18 think it is important to recognize that prices are
19 shaped by a lot of things, and it's important not
20 to draw too much from a correlation... And again,
21 as I say, the correlations in some cases actually
22 would suggest a different point.

1 So, I think all of this though, the
2 decline in prices overall, I think just reinforces
3 the need to come up with a position limits regime
4 that, again, meets the congressional goal of
5 limiting excessive speculation, the risk of
6 excessive speculation, while enabling people to
7 hedge effectively.

8 So, I look forward to today's
9 discussion. I'm sorry, I won't be able to
10 participate in all of it, but again, appreciate
11 your presence.

12 SPEAKER: Chris [Mark], do you want to
13 go next?

14 COMMISSIONER WETJEN: Good morning.
15 Welcome. Nice to see everyone again. Chris,
16 thank you for convening the meeting today, I'm
17 looking forward to today's discussion.

18 I, too, had some meetings last week, and
19 learned a great deal. The meetings were focused
20 on the ag sector, and included folks from the
21 producer community, the cooperative community,
22 serving as intermediaries, again, in the ag sector

1 primarily, manufacturers and significantly sized
2 merchants. And it was a fascinating set of
3 meetings, and we learned a great deal.

4 There certainly should be some concern
5 based on the fact that so many people's
6 livelihoods depend on the prices of commodities.
7 And so, the fact that there has been such a
8 decline is obviously very, very relevant. I
9 thought another thing that was interesting to
10 hear, is that the, at least in the ag sector, and
11 we've heard in previous meetings, both in MRAC and
12 perhaps even in EEMAC before, I can't remember for
13 sure, but the ag-derivative market seem to be
14 functioning very, very well, and I guess, as we
15 focus on position limits, I think that's an
16 important thing we need to bear into account.

17 Accessibility to the market seemed to be
18 quite good. There were no complaints, and again
19 this is just a subset of the marketplace that we
20 visited with, but no complaints about being able
21 to access the market. The one thing that was
22 interesting to learn, is that while some used to

1 do OTC contracts in ag products that no longer
2 takes place, but they are finding ways to manage
3 risk in other ways.

4 I thought in a lot ways it was
5 heartening to hear a lot of what we heard, at
6 least in the ag space, that marketplace seems to
7 be functioning quite well, liquidity was pretty
8 good. Customer service was pretty decent among
9 the IB crowd, and customer service and
10 accessibility, again, seem to be pretty healthy
11 from the FCM perspective. So, all that was very,
12 very positive.

13 As the Chairman said, you know, the
14 statute obligates us as a Commission to impose a
15 Federal position limits framework. I've said that
16 before multiple times now. But what it does not
17 obligate us to do, is to impose a framework
18 that's, in Chris' words, wooden and rigid, or
19 otherwise divorced from the realities in the
20 marketplace. Those words do not appear in the
21 statute, and we are not required to do that, so we
22 have to cognizant of the market dynamics in these

1 cash markets as we put together a policy for
2 limits in the derivatives markets.

3 And so I'm especially interested in the
4 first panel, and again, this is something that
5 I've spoken about before when we re-proposed a
6 Position Limits Rule, there has to be a workable
7 way that we deal with non-enumerated hedges.

8 I understand there could be some work to
9 do, in terms of what also might included as an
10 enumerated hedge, but beyond that we have to bear
11 in mind the realities of the marketplace and the
12 realities facing the Commission, about how, as a
13 Commission, we are going to deal with those
14 transactions that do not neatly fit into the
15 definition -- one of the enumerated hedges defined
16 in our rules. So, it seems to make a heck a lot
17 of a sense that we would try and leverage both the
18 expertise and the resources, frankly, by the
19 exchanges to help us in that effort.

20 So, especially looking forward to this
21 first panel, as well as the subsequent panels; and
22 again, it's great to be here, it's great to see

1 all of you here convened, and looking forward to
2 the meeting. Thanks.

3 COMMISSIONER BOWEN: Thank you. And
4 good morning. It's good to be here for another
5 meeting of the Energy and Environmental Markets
6 Advisory Committee. And, for those of you who
7 traveled here from out of town, thank you for
8 braving D.C.'s less-than-pleasant weather to be
9 here today. We are covering some important
10 topics, and I look forward to hearing the views of
11 this Committee.

12 I have had the benefit from hearing from
13 many end-users, such as farmers, ranchers, energy
14 producers, utilities and manufacturers this past
15 year. I appreciate the time you all devoted to
16 share your concerns, and for your continuing
17 commitment to fulfilling the vital role you play
18 in our economy.

19 The Commission recently released new
20 guidance regarding forward contracts with embedded
21 optionality. As I have said before, I support the
22 Commission's efforts to provide legal clarity

1 regarding these products. And it is important that
2 we provide relief, so that end-users, particularly
3 those in the energy and agricultural spheres, can
4 continue to utilize these contracts for hedging
5 and also have certainty about their treatment.

6 Yet, I think we need to do more.
7 Options and forward contracts are distinct
8 categories under the Commodity Exchange Act. If a
9 contract, or some portion of a contract, meets the
10 definition of an option, that portion which is an
11 option inherently cannot be a forward contract.

12 A product that is embedded with
13 volumetric optionality, or EVO, may be a forward
14 if the optionality is being utilized as a forward.
15 If, however, an entity attaches EVO to a forward
16 and uses that product as an option, the overall
17 product is not a forward and cannot qualify for
18 the exclusion.

19 I believe the Commission does have a
20 route for providing the clarity that market
21 participants are seeking, and I have proposed that
22 the Commission use its exemptive authority to

1 provide an additional, easier solution for
2 obtaining the relief that these stakeholders are
3 requesting. I look forward to reviewing the
4 comments the Commission receives and working with
5 my colleagues here to see what more we can do.

6 I also want to speak briefly about
7 position limits. Nearly eight months ago, we
8 re-opened our comment period on the position
9 limits, something, frankly, we've done quite a bit
10 recently. At that time I said, I support
11 reopening the comment period, but we cannot allow
12 this rule to linger indefinitely on our docket.
13 It's been over a year since we reopened this rule,
14 and nearly four years since it was first proposed.
15 It has now been nearly another year, spring has
16 turned into late summer, and this rule still has
17 not been finalized.

18 Having reviewed summaries of the
19 comments submitted over the last year, I think
20 we've seen pretty much all the original comments
21 we're going to see. In the last comment period,
22 many comments restated previous ones; in some

1 cases, almost identically; so, I get the sense
2 that commentators not only feel strongly about
3 their positions, but want to make sure we are
4 hearing from them loud and clear. And we do.

5 I therefore do not think it makes sense
6 to reopen the comment period for this rule again,
7 unless it is necessary to seek public input on
8 some new, additional approach or proposals that
9 the Commission has for addressing certain
10 concerns. I think we really need to buckle down
11 and finish this rule.

12 Thank you again to the Committee and the
13 sponsorship of Commissioner Giancarlo for
14 providing this opportunity to hear from you today.

15 COMMISSIONER GIANCARLO: Thanks, Sharon.
16 Thanks, Tim. And thanks, Mark. We'll now hand it
17 over to our Committee Chairman, Michael Cosgrove.
18 Thank you, Michael.

19 MR. COSGROVE: Okay. Well, so we have
20 our first Panel, How Can Exchanges Help Implement
21 Federal Position Limits, and I think without any
22 further ado -- Well, actually should we introduce

1 ourselves, or having done that once before, is
2 that reasonable?

3 COMMISSIONER GIANCARLO: We have a
4 pretty tight agenda, Mike, so I think maybe we'll
5 dispense with that if that's all right. But maybe
6 we can have the Panelists introduce themselves.

7 MR. COSGROVE: Okay. Great. Well, I
8 think without further ado then, if you guys would
9 like to introduce yourselves and begin, we are all
10 ears.

11 MR. OPPENHEIMER: I'm Ron Oppenheimer,
12 and I'm here representing the Commercial Energy
13 Working Group.

14 MR. LaSALA: I'm Tom LaSala; I'm the
15 Chief Regulatory Officer for the CME Group.

16 MR. HAAS: I'm Erik Haas, Market
17 Regulation with ICE Futures, U.S.

18 MR. LaSALA: I will begin. First on
19 this Panel, I would like to speak to what I have
20 called the impact analysis covering the period of
21 June 1, 2014 through June 30, 2015. What I'm
22 trying to illustrate for the Committee in this

1 particular presentation is basically a furtherance
2 of materials that were touched on and presented by
3 the CFTC in the rulemaking, generally speaking,
4 under Table 11A.

5 So, in that table what effectively
6 transpired was the Commission detailed out impact
7 points, how many participants would have been
8 affected by the imposition of position limits,
9 whether it be single months, all-months, spot
10 months. I'm focusing here on single months and
11 all- months combined, and the rationale that I'm
12 looking to pass forward here is that I'm
13 overlaying -- I'm trying to overlay what that
14 imposition of those limits could have to
15 legitimate positions held by commercials as well
16 as non-commercials, and how those positions, if
17 affected by the limits, will effectively
18 ill-affect the workings of these markets.

19 So today, I think everyone is aware, and
20 I've highlighted in this chart various energy
21 contracts as well metals and I'm going to focus on
22 energy, but we are operating in an accountability

1 paradigm today, not limits. And I want to speak
2 to the details of the chart in just a moment, but
3 I think it's helpful if I could first just
4 reinforce a couple of critical concepts on how
5 that accountability paradigm is operating today.

6 So, to further and enhance liquidity,
7 while being mindful of concentration, we
8 effectively set certain thresholds for open
9 interest and monitoring all these markets. And
10 they are different. Meaning that, if there was no
11 open interest in a particular month, and Erik and
12 I traded 500 lots opposite each other, the
13 position would be concentrated, it's 100 percent
14 and the open interest is 500 lots.

15 The point is, is that you can't impose a
16 liquidity or concentration standard there, you
17 would just squelch the formation of liquidity.
18 So, we set on a market-by-market basis, in
19 operating accountability paradigm, certain
20 thresholds and they vary. So when certain back
21 months get to, or all months get to a certain
22 threshold, we begin looking and managing

1 concentrations in those contracts.

2 And the profile of how we look at that
3 concentration, frankly, across the curve, is
4 different. As you might imagine in the near-term
5 months we might be becoming more sensitive with
6 positions when they are in the 20 or 25 percent of
7 open interest range. As you get further out the
8 curve that percentage could, in fact, increase,
9 and it does.

10 So, I think these contracts have been
11 managed under the accountability paradigm, and I'm
12 going to use the word "successfully."
13 Successfully because as I go through some of the
14 examples here, where I'm going to show you the
15 impacts, not only on the number of participants,
16 but a greater level of granularity as to how many
17 days these participants were affected within the
18 target period, June 1, 2014 through June 30, 2015,
19 and also the magnitude of how many positions over
20 the said limit those participants were, as well
21 what -- and I chose to highlight the peaks -- what
22 those peak concentrations actually look like.

1 And what I think you'll find and
2 conclude is that that accountability paradigm did
3 operate effectively and, in fact, if we imposed
4 the single and all-months limit as proposed with
5 the formula, and I denoted what that proposed
6 limit would be, you will have significant impacts.

7 And so, let's take an example, if we
8 could. I'm going to use the single -- and focus
9 up at the top, we've broken this chart out by
10 non-commercials, commercials, and then I did in
11 fact present an aggregate view. So, I'm going to
12 look at RBOB in the noncommercial category.

13 The proposed CFTC limit per the formula,
14 11,800, the number of participants over a single
15 month, it's an asterisk because it means there
16 were fewer than 4. We chose not to identify
17 specific numbers below that level, we didn't want
18 folks to try and infer who a participant might be.

19 So with, you know, fewer than 4, so 3 or
20 less, the average amount over a single month in
21 RBOB for that period was 2,696 positions. The
22 peak was 6,255 positions, so a peak of one of

1 those 3 or less was at 6,255, and the peak
2 concentration percentage was 17.20 percent, and
3 the number of days that the cumulation of the
4 party, so those three were over, amongst them, a
5 total 217 days, so it may even 100 -- 117 days if
6 there were 3.

7 Looking at the all-months 4 affected
8 participants, but again, what was the average of
9 the parties' positions that were in excess of that
10 11,800; 5,721, the peak 9,934; the percentage of
11 the peak, 5.59 percent, and the affected days 291.

12 So, what I'm concluding and putting
13 forth to Commissioners and to the Committee is
14 that these positions were allowed to exist in
15 excess of what the would-be limit would have been.
16 I would assert to you with no casualty insofar as
17 ill-affecting the market, in fact, in this
18 example, and if the Committee would want to go
19 through all those, I'm happy to. Those
20 non-commercials were in fact providing valuable
21 liquidity.

22 And I'm not saying liquidity in the

1 context of their -- at the top of the central
2 limit order book, providing a bid-ask all day.
3 No. They are taking on positions, positions
4 opposite commercials in the marketplace who need
5 that liquidity, that liquidity yields open
6 interest. That open interest yields more
7 liquidity to allow these markets to, in fact,
8 function properly.

9 So, I'm not dismissive that -- where in
10 any means, the positions should be unlimited. In
11 fact, you know, across the period there were a
12 number of instances, 44 in fact, where we reached
13 out to participants to question, because they
14 broke through one of our thresholds. We
15 questioned them about the details of what that
16 position represented, and we set for them a
17 framework of where, I would say, the sensitive
18 points are in terms of concentration.

19 So by effectively reaching out, engaging
20 and illustrating to market users, whether it be in
21 RBOB or any of these markets, I think the
22 marketplace understood where the sensitive points

1 are and we avert the circumstance where we have
2 to, in many instances, order people to either
3 reduce or not increase or hold. We did have three
4 of those instances where we did have to say hold,
5 hold your position, and they did; so, again, some
6 context.

7 I'd like to, if I could, one more
8 example in the commercial category, and then
9 certainly per any questions on any of the
10 particular commodities, I'll answer them, or any
11 more generic questions, happy to field them. But
12 if we look at RBOB again now in the commercial
13 category, that same limit, the affected parties in
14 a single 3 or less, you see the average overage,
15 the peak 12,000 and change, a 16.44 percent peak
16 concentration; 123 days, you know, across those
17 participants moving to the all-months.

18 Five participants, the average 4,981;
19 the peak 13,854; the peak percentage, the
20 concentration 5.48 for a total of 537 days that
21 commercials were affected; and while I think we
22 all know and we are going to be talking later in

1 this Panel, about commercials and exemptions, as
2 proposed today, things change, so where some of
3 these parties, you know, if strict limits were
4 administered per these levels during this period,
5 if the paradigm for exemptions was narrowed,
6 constricted, some of those commercial may not have
7 been able to maintain those open positions.

8 And while I think it's the goal of many
9 sitting in this room today, to further explore, as
10 the Chairman and the Commissioners have said,
11 getting to the right place on the exemptions, I'm
12 simply pointing out that you are getting a clear,
13 I believe, profile here of what that impact could
14 be to commercial users as well as non-commercial
15 users.

16 So, again, I'm certainly open to speak
17 with any level -- whatever level of detail you
18 would need on any of the markets. I focused on
19 the energy, I did highlight the metals for
20 everyone to take a look at, and certainly
21 available to take any questions. Thank you.

22 MR. COSGROVE: Shall we continue and

1 have our questions at the end of the panel?

2 MR. LaSALA: Sure.

3 MR. COSGROVE: So, is that all right?

4 MR. LaSALA: Absolutely!

5 COMMISSIONER WETJEN: Tom, one real
6 quick question. For purposes of your -- the data
7 there in the presentation, how do you define
8 commercials?

9 MR. LaSALA: The commercials would be, I
10 think, very similar, Commissioner Wetjen, in
11 relation to how the Commission defines them in the
12 COT. So you'd have producers, refiners, there
13 would be oil traders in that category, we would
14 have also included swap dealers in that, so it
15 would be the swap dealers and the others I just
16 mentioned.

17 MR. OPPENHEIMER: Good morning. Again,
18 I'm Ron Oppenheimer representing the Commercial
19 Energy Working Group. And before I begin I want
20 to thank all of you and the Commission staff for
21 spending so much time on this Rule. I know it's
22 been extensive and it's very much appreciated.

1 The Commercial Energy Working Group's
2 view has been all along, if we are going to have a
3 Position Limits Rule, let's work to get the Rule
4 right, and we really appreciate the time and
5 effort that you all have been putting in to do
6 that, to focus on that same objective.

7 My presentation today is really a
8 continuation of the presentation I made at the
9 last EEMAC meeting. At that time we discussed how
10 the narrow definition of bona fide hedging in the
11 proposed rule would limit some of the risk-
12 reducing behaviors of commercials in the
13 marketplace currently. And how eliminating their
14 ability to reduce their risk would add cost into
15 the system, and how that cost ultimately is borne
16 by consumers of energy products, so it's an
17 important consideration.

18 Now, at the meeting and since, as has
19 been said in some of the opening statements,
20 several of you have expressed a willingness to
21 consider relying on the work that the exchanges
22 do, to consider where non-enumerated hedges might

1 fit into the framework of a Position Limits Rule.
2 And we think that's very constructive. The
3 exchanges have the knowledge, the expertise and
4 the regulatory incentive to carefully scrutinize
5 the exemption process, and they already engage in
6 a parallel process for their own interest in self-
7 regulating and ensuring convergence and orderly
8 liquidation of futures contracts as they come to
9 expiry.

10 So, over the past several weeks the
11 Commercial Energy Working Group has engaged in a
12 lot of discussions with ICE and CME over what a
13 possible framework could look like, and we both
14 describe it today, really not as advocacy, but as
15 the basis for a discussion as to whether it
16 provides a viable solution that could break the
17 logjam that has existed in this space for however
18 long you want to count it, at least five years,
19 and allow us to move forward on this important
20 issue.

21 So we could go -- The benefits of
22 relying on the exchanges are pretty obvious. The

1 first is that it avoids resource duplication.
2 Secondly, it capitalizes on the depth and breadth
3 of the designated contract markets, experiencing
4 and evaluating hedging strategies in the energy
5 space.

6 As I said before, they are engaged in
7 active oversight of market participant positions,
8 particular in the front market, as I said to cover
9 convergence and orderly liquidation. Very
10 importantly it's not disruptive to current
11 end-user hedging practices. And in this regard,
12 Tom referred to Table 11-A, I would also like to
13 refer to Table 11-A, but particularly as it
14 affects the spot month. Tom was look at the any
15 and all-months.

16 In the spot month as you look at it, the
17 number of people over the potential spec limit in
18 the physical-delivered commodity is extensive.
19 Over 80 in natural gas, 40 and 30 in the other
20 energy commodities, those people have to be
21 operating today under exchange-granted hedge
22 exemptions. If we change the definition of what

1 constitutes a bona fide hedge from what the
2 exchanges are currently applying to the narrow
3 definition in proposed rule, all 80 of those
4 people's hedging activities will be impacted, and
5 40 in the products, and 30 in the others. So,
6 it's very, very important that we get this right,
7 to not disrupt active hedging practices.

8 And the last point is that it provides
9 flexibility for market innovation and evolution.
10 A single list of enumerated hedges without the
11 possibility of non-enumerated hedges eliminates
12 the possibility that we'll be able to capture
13 what's not -- practices not engaged in now, and
14 not foreseen today. So all very important.

15 There are really three steps in the way
16 forward. The first is that we address the types
17 of hedging that have been in comment letters and
18 petitions over the last several years, and revise
19 the list of enumerated hedges to include those.
20 We've had substantial dialogue on them, it has the
21 additional benefit of narrowing the areas where we
22 would have not -- a need for non-enumerated

1 hedges, and have to rely on a different paradigm
2 for that. So it's an important first step.

3 The second is that we would request that
4 the Commission consider advising that the
5 positions and strategies that DCMs have currently
6 employed in their rules be continued going
7 forward. And we are not saying here that any
8 specific practice should be -- or any
9 company-specific positions should be recognized or
10 grandfathered, what we are really saying here is
11 that there should be a general endorsement of the
12 types of practices referred to in exchange rules.

13 I'll just say for example, CME Rule
14 559-B talks specifically about anticipatory
15 hedging and storage, and some of the other things
16 that we've talked about, so we'd be looking for a
17 general endorsement from the Commission of that
18 kind of activity as being appropriate for hedging
19 exemptions.

20 And that's important, too, because we
21 need to look at the statutory framework, both
22 Sections 4(a)(c), and 4(a)(a)(7) are available for

1 the Commission to do that, to acknowledge that
2 those kinds of practices should be the subject of
3 hedge exemptions.

4 And finally, and the lynchpin to the
5 framework to rely on the exchanges is this, the
6 Commission could, by rule or by statutory
7 interpretation or order or exemption, or whatever
8 procedural vehicle it felt was appropriate, the
9 Commission could state that in the event a DCM
10 recognized a particular strategy as being a valid
11 non-enumerated hedge to be used as an exemption in
12 their markets, that a party relying on that
13 exemption could also take similar positions and
14 strategies in the OTC markets, and rely on a non-
15 enumerated exemption for those positions as well.

16 There would be a review process, I know
17 somebody mentioned in the opening, I'm not quite
18 sure who, I guess it was Commissioner Giancarlo,
19 that this would not mean that the process would
20 not be subject to Federal oversight, we'll get to
21 that in a minute, but there absolutely would be a
22 process for the Commission to consider whether or

1 not the exchanges were appropriately exercising
2 the authority that we would be delegating to them.

3 The process would rely, very much, on
4 existing process, and in that sense that's really
5 a benefit I think to both the market and to the
6 regulators. An annual application would be made
7 to the DCM identifying what a particular
8 commercial entity's hedging needs were, what its
9 business activities are; an application which, of
10 course, could be supplemented if things changed.

11 And just, I'm going to throw out some
12 numbers, we can get back to an example and talk
13 about it a little bit more specifically later.
14 But I'm going to throw out some numbers just to
15 give you sense of what we are talking about. So,
16 in that application, for example, a commercial
17 could show that they had expected exposure of
18 8,000 lots of futures equivalent, a combination of
19 a variety of different potential non-enumerated
20 exemptions.

21 What the exchange would do, and what it
22 currently does, is it would analyze that

1 application both in terms of whether or not the
2 strategies claimed qualified for an exemption, but
3 also whether or not the exposures seemed
4 reasonable to the exchange. So, an applicant
5 might say I did X last year, I've increased my
6 staff, I expect to do 20 percent more than X, the
7 markets are changing, I expect to do another 10
8 percent in some area. The Exchange scrutinizes
9 that, and they say, yeah, that's nice, we see what
10 you've done in the past, we see what you are
11 expected to do in the future, we think you may be
12 being a little bit optimistic. Instead of 8,000
13 we'll recognize that you have, for example, 6,000
14 lots of exposure in the coming year ahead.

15 And then they issue -- then they
16 consider what their market can actually bear, and
17 in some contracts there might be enough liquidity,
18 they'd sure you can have an exemption of 6,000
19 lots. In others they might say, you know, there's
20 not enough liquidity, we don't see enough
21 experience on your part in this market, a variety
22 of other considerations, and they might say, for

1 our market, you can have a 4,000-lot exemption.

2 And then they send you a letter and they
3 describe what they've done and they establish that
4 limit as the limit on what you can do on their
5 market. I will point out a couple of things here,
6 not on the slide, but this comports very closely
7 with Commission practice, both in existing
8 practice in the ag markets, in the Vacated Rule
9 and in the Proposed Rule in that, like a 704
10 filing, you have an advanced explanation of what
11 the hedging practice is likely to be, you have an
12 analysis of how robust both the strategy and the
13 size of the positions are, and you have an actual
14 limit established for the non-enumerated positions
15 that would be taken. It also comports with Rule
16 1.48 that's currently used in the ag markets for
17 non-enumerated hedges.

18 The next step in the process would be
19 new, and in that part of the process for any
20 non-enumerated hedge that was granted, the DCM or
21 SEF would provide a notice to the Commission, and
22 that notice would identify the non-enumerated

1 hedge exemption that had been granted, giving the
2 Commission an opportunity to review it and
3 understand it.

4 It would include the DCM's conclusion as
5 to the size of the party's exposure, that 6,000
6 lots that I referred to before. And it would tell
7 the Commission that it had granted the 4,000-lot
8 exemption. An important note here, that notice,
9 which would show a party's individual exposure
10 would have to be given complete confidentiality;
11 otherwise it would expose the party substantially
12 in the marketplace.

13 So, the outcome of all of this is that
14 we would have a paradigm for non-enumerated hedges
15 where an exchange would set a limit for what could
16 be done on its market, and it would also set a
17 limit, i.e., its analysis of the exposure for what
18 could be done across all markets. So that 6,000
19 number that I identified before, which would
20 represent their view of a party's exposure, a
21 party would be allowed to take that across DCM,
22 SEF and OGC [sic - OTC?] markets, assuming of

1 course that no DCM or SEF that had given a
2 specific limit, in this case the 4,000 that I
3 referred to, could a party exceed that specific
4 limit on that market. And again, we'll go back to
5 an example at the end to just walk through that
6 and make sure that its clear to people.

7 A very important part of this whole
8 framework is certainty. Reliance on DCM
9 determinations needs to have certainty to be
10 effective for the marketplace, we've been debating
11 these points for a long time, we need to put that
12 to rest, either by getting them onto the list of
13 enumerated hedges, or relying on what the
14 exchanges do and have done historically.

15 And the review process that I mentioned
16 earlier is this, if the Commission or its staff
17 doesn't agree that a particular non-enumerated
18 hedging strategy qualifies, either when it gets
19 one of those notices, during a rule enforcement
20 review, or really at any other time, that
21 treatment could only be changed prospectively, and
22 on full Commission review, giving the public an

1 opportunity to participate in the discussion on
2 that, and whatever appropriate procedural vehicle
3 the Commission uses for that, I leave to those who
4 know the APA better than I do.

5 So, there are a couple of things that
6 aren't addressed in this approach. I'm not going
7 to go into them now, but they are important, the
8 economically-appropriate test which we discussed
9 at the last EMAC, Cross Community Hedging, the
10 so-called Five-Day Rule, and the reporting forms
11 that are in the proposal, Form 204, which is
12 currently in place and some of other new reporting
13 requirements. These are all things that need to
14 be addressed, but they are outside the framework
15 that we are putting forward today.

16 And again, I want to thank you for the
17 opportunity to put this out there, we really hope
18 it advanced the ball, we've tried to address the
19 Commission's regulatory interest and ensure that
20 claimed exemptions are legitimate, while at the
21 same time preserving hedging opportunities that
22 reduce the cost of energy commodities to

1 consumers.

2 Now, we look forward to answering any
3 questions that you have and discussing this
4 further over the next hour or so. Thank you.

5 MR. COSGROVE: Erik?

6 MR. LaSALA: So, I am going to, if I
7 may, continue, follow Ron, and give some context
8 in furtherance of the presentation Ron has made
9 from the exchange perspective. I believe this is
10 an interesting circumstance we have, because I
11 think folks will recall a year ago, it was not --
12 CME Group and ICE were at a roundtable and put
13 forward the notion that there's a possibility that
14 we could be of some assistance in the process in a
15 non-enumerated structure.

16 We recently, you know, we were engaged
17 to see if, in fact, what could we come up with.
18 So we did have engagements, not only with Ron, but
19 others and, you know, Erik Haas and I representing
20 ICE work together, very much looking at it from
21 the standpoint of what were, not only the needs of
22 the users, but what -- from an exchange

1 perspective we thought made practical sense and
2 was workable.

3 And although many of the concepts where
4 we've landed reflect exactly a landing point where
5 we think we have intercepted and we have a
6 solution. They were certainly seeing as -- there
7 is an evolution that's occurred during this
8 engagement.

9 So, what I'd like to do here, Erik and I
10 are going to split up this part of the
11 presentation, I just want to highlight very
12 broadly some of the points of or cornerstone
13 points, Ron has mentioned them, turn to Erik, have
14 him speak a little bit to, more broadly, that
15 existing exemption process that we engage today,
16 that I'd like to explore some of the real details
17 from an exchange perspective on the non-enumerated
18 process that we've conceptualized.

19 So, in terms of cornerstone points from
20 an exchange perspective, these are, again, in
21 furtherance of what Ron said earlier, we certainly
22 would like to see the list of enumerated,

1 recognized enumerated exemptions be expanded.
2 Whether it be through rule or order, but some
3 structure that, in fact, the Agency permissions
4 the exchanges, like DCMs, SEFs, in order to
5 administer this non-enumerated process.

6 And then, lastly, some structure, and
7 we've had discussions, that's practical, I think
8 we use the word here wholeheartedly, if the
9 Commission does determine to administer and allow
10 the -- delegate might be too strong a word -- but
11 allow the exchanges to administer this process, it
12 has to be genuine, allow us to make those
13 decisions, we'll talk to you about our processes,
14 when we make them, however, there is a process.

15 You know, we talked about some form of
16 interpretive action process or other, whereby the
17 Commission could come in after the fact, look at
18 the decisions made by the DCMs, the SEFs, and say,
19 you know what, on this one, we have an issue, and
20 in that process, I'll say involved parties have a
21 right to explain what their perspectives are, how
22 we got here, that ultimately the Commission would

1 go for some type of a formal, public position
2 representing that outcome.

3 So, with that, those cornerstone points,
4 I'm going to turn it over to Erik Haas at ICE, and
5 allow him to go through some of the processes in
6 the exemption world.

7 MR. HAAS: Thank you. So, as you
8 consider this as a potential option, we wanted the
9 Commissioners and the Committee to understand what
10 has been referred to a few different times, what
11 the process really is. And so, we are going to go
12 through our existing exemption process, and with
13 energy having expirations every calendar month,
14 this is a monthly and very routine process for us.

15 It starts out with an application being
16 filed with the exchange by the applicant. They
17 have to come to us and tell us the level they are
18 requesting and what the underlying strategy is.
19 They'll provide documentation supporting their
20 exposure as well as they have to give us their
21 risk-management policies and what their internal
22 compliance and position-limit monitoring

1 procedures are.

2 From that point the market regulation
3 department at the exchanges reviews this, we'll
4 first look at the justification that they've
5 provided to support the level they are requesting.
6 We'll review the underlying exposure, number one
7 to make sure it's appropriate, that it exists,
8 that they have some documentation supporting that
9 this is real exposure.

10 We will determine whether the amount
11 that they are requesting from a limit level lines
12 up with their underlying exposure, if it doesn't
13 at that point generally we'll go back to the
14 applicant and explain that to them, that on our
15 end what we see is that the level you are
16 requesting is greater than the exposure you
17 provided.

18 We can give them an opportunity to,
19 maybe, submit more information if they've left
20 something off, or make a determination that they
21 don't get the level. Throughout this, there is a
22 considerable amount of follow-up conversation in

1 the review phase, we routinely go back to the
2 applicant, ask for more information, get
3 clarification on certain policies and procedures,
4 and I think we've done a pretty good job with it,
5 since, in Ron's presentation the working group
6 pretty much explained our exact process on his
7 own. They are now very familiar with our
8 interactions at both exchanges.

9 After our review process, market
10 regulation is going to make a determination, and
11 as noted, we can approve the exemption, deny it,
12 or conditionally approve it. And what
13 "conditionally approve" usually means is, if an
14 applicant comes to us and asks for 50,000 lots and
15 they have the justification of 50,000 lots, we
16 might determine that that's not appropriate at the
17 time for the market or for that participant.

18 So a lot of times what we'll do is,
19 we'll say, you can have 25,000 lots. If you get
20 to 25,000 lots, you've already demonstrated that
21 you have more exposure, come back to us, we'll
22 look at the market fundamentals, we'll look at

1 your procedures, and at that time, we'll make a
2 decision on potentially bumping you up.

3 But what we are trying to avoid is
4 giving any one commercial participant, the ability
5 to just take their position up to the maximum of
6 their exposure, and to avoid any detriment to the
7 market that might occur from that. So we are
8 really trying to manage, not only the exemption
9 process but how the positions are put on, and
10 ultimately, if needed, how they are going to be
11 taken off.

12 COMMISSIONER GIANCARLO: Erik, I have a
13 question for you. What level of human and other
14 resources do you have in place now to manage the
15 exemption process? And what additional level of
16 resources would you need if there was the
17 delegation that you are talking about? And
18 perhaps you and CME could also answer that
19 question.

20 MR. HAAS: Currently we have across ICE
21 Futures U.S., I'm going to say, there's probably
22 15, 20 people devoted to market surveillance, and

1 then that market surveillance, that includes
2 managing exemptions. And internally we have three
3 different applications that are utilized to review
4 exemptions, which is an extensive process even
5 working with, say, a commercial that we are very
6 familiar with, and we've had a good relationship
7 with them, and it's an annual exemption, so each
8 year they are going to generally come in and renew
9 it, it's still a brand-new process.

10 And so the third year, we are familiar,
11 we know what they are doing, we know what their
12 exposure is. It's still, I would say, a five-day
13 process for us to go through all the
14 documentation, make our own documentation, make a
15 record of what we are doing and why, to expand it,
16 it can be done, we would have to see the extent of
17 what comes in, to make a determination if our
18 existing staffing can handle it. Since Ben is
19 here I'm going to say it can't, and we'll have to
20 definitely increase staffing, probably sooner.
21 Thanks.

22 MR. COSGROVE: Go ahead.

1 MR. LaSALA: Sure. Commissioner
2 Giancarlo, I would say at the CME Group across the
3 asset classes, there's approximately 7 to 8 people
4 that are looking at exemptions across the various
5 asset classes, they are part of the market
6 surveillance group, which is a much larger team in
7 general, but 7 or 8 people. In terms of -- I
8 think we could certainly -- in handling the load,
9 I think that one of the interesting points here
10 we'll get to later is the OTC positions.

11 I think that in terms of handling
12 exemptions on our markets, I tend to think that we
13 can probably kick this process off at current
14 staffing levels. I can give you some context, and
15 referring back to that time period I spoke about
16 earlier with the impact analysis, we processed in
17 the energy space 167 separate applications, and
18 just to give the Committee some context around the
19 integrity around that process, and similar to what
20 Erik had mentioned, these are not all just simply
21 approved. A lot of these are considered reduced or
22 denied.

1 So, of the 167, 114 of them were
2 approved but at less-than-requested levels based
3 on either a host of constrictions that we viewed
4 insofar as the market's ability to handle the
5 position, or some frailties with the underlying
6 exposures; 49 were approved as applied for, and 4
7 were denied. Thank you.

8 MR. HAAS: Back to the determination
9 process. After we make our determination, we are
10 going to give, in our approval letter, the
11 applicant the amount they've been granted, we note
12 the spot month limit, what they can hold on top of
13 it, and we're specific to what strategies they've
14 been granted. So, if at any time in the future
15 they hold a position over the limit, they are
16 aware of what their underlying strategies can be
17 for that position.

18 We don't want any confusion later on
19 where they feel that had an ability to use a
20 different strategy, and we're not on the same
21 page, so again, our process with this is, we are
22 trying to be as clear as we can with the market

1 participants, so they know exactly where we stand,
2 and we know that they know that.

3 Adding to it, we don't give special
4 consideration to commercial participants just
5 because they are hedging, as Tom noted, you are a
6 commercial participant, you have a hedging need,
7 but we also have to manage our markets, and so we
8 will cut them down at times on their requested
9 level, and touching back on the accountability
10 process, for our energy contracts, we do have
11 accountability levels out the curve, and doing
12 those accountability reviews, we don't exclude
13 commercial participants, even though they have a
14 spot month exemption.

15 We'll still look at them out the curve,
16 and if we feel that, out the curve, their position
17 is too large or could be a problem, we are
18 contacting them, letting them know, and can manage
19 that process. So, this isn't a -- on the exchange
20 side, it isn't a process where, you are a
21 commercial, you come in and tell what you need and
22 you get it. We are managing our market, we are

1 not treating them really any differently than any
2 other market participant.

3 And then finally, after we provide our
4 approval, assuming it's an approval, we have an
5 ongoing surveillance requirement, and even though
6 the commercial participant has the exemption, we
7 are following up with them in the future,
8 reviewing their position and sharing that if they
9 are over the limit, under the basis of an
10 exemption, that their positions are tied to that
11 exemption, and that at any point, that exemptive
12 position isn't causing a problem in the market.
13 So, ultimately the market price being not
14 disruptive due to even a commercial is our biggest
15 concern.

16 MR. OPPENHEIMER: Can I just add a very
17 quick point to that and you can both correct me if
18 I misstate this, but and you retain the ability to
19 revoke an exemption if market circumstances are
20 such that that exemptive size position would be a
21 problem, in addition to jawboning authority to
22 just convince the market participant to get out if

1 it poses that kind of a potential.

2 MR. LaSALA: Yes, to all. Yes. So, if
3 I could, and thanks; let me continue with some
4 further details about the process from the
5 exchange perspective. As both Ron and Erik
6 discussed, an application would have to be filed.
7 And I'll note to the Committee that, and the
8 Commissioners, certainly, that I would envision
9 that the applications -- we process, as Erik said,
10 these applications yearly on an interim basis if
11 needed. What I would envision is the parties that
12 come to us on a yearly basis would take the
13 applications that we have that would be modified
14 as necessary, and not only include their
15 enumerated exposures, but their non-enumerated
16 exposures.

17 In fact, some of that is on applications
18 today. Again, I would tend to think in the same
19 cycle, we would be integrating the totality of
20 those requests. Again, nothing would stop someone
21 from subsequently coming up with a new type of
22 non-enumerated exposure and coming to us, but I'll

1 note, that in the first bullet, we want to
2 certainly deal with the non-enumerated ones in
3 advance of assuming the positions in the
4 marketplace.

5 Again, I do see this as somewhat of an
6 extension of what we are already doing. So, as
7 Erik said, the DCM or the SEFs would approve or
8 deny, conditionally, the exemption request, and we
9 would assign a number on our respective markets.
10 It could be, as I mentioned earlier, at the level
11 requested, could be at less than the level
12 requested, and there could practically be, and
13 we'll go through an example later, a comingling.

14 Meaning that a party might come to us,
15 and say I've got 5,000 contracts of enumerated
16 exposure, I've demonstrated -- I demonstrate 1,000
17 contracts of non-enumerated, anticipatory
18 merchandising, and additionally 1,000 contracts of
19 non-enumerated storage hedges.

20 Well, we'd encapsulize all that, you
21 know, if we felt comfortable that the
22 documentation was correct, we still might say that

1 our exemption to you is 5,000 contracts of which
2 it can be basically populated by the enumerateds
3 or some combination of enumerateds and 1,000 each
4 of the two non-enumerateds, if that makes sense.
5 So, again, I could certainly see that kind of a
6 circumstance, where we are looking at the totality
7 of the different types of exposures and denoting
8 them.

9 Mentioned by Ron, earlier, in that
10 letter we would also do another very important
11 thing that's not what we do today. In the letter
12 that we would prepare to the participant, we would
13 have had to have done an analysis of that
14 underlying exposure with regard to that
15 non-enumerated hedge. Again, we will go through
16 an example with numbers, but let's just say,
17 hypothetically, that it was 5,000 contracts of
18 anticipatory merchandising, where we only grant an
19 exemption of two; the letter is going to, in fact,
20 contain both the numbers.

21 The number that we granted, and just as
22 a note, what I'm focusing on here, and I should

1 state this upfront, I'd like to open in the
2 context of a spot exemption, to keep simple. We
3 granted an exemption of 2,000 because we were
4 comfortable with that, but the exposure might
5 greater, maybe 5,000. We are going to include
6 that 5,000 in the letter that goes to the
7 participant.

8 Additionally -- I'll go to the next
9 slide -- we are going to forward, collectively,
10 between, you know, whether it be Erik, myself, or
11 any other DCM or SEF, those letters to the CFTC,
12 effectively, by virtue of the fact that we are
13 setting, we are granted authority in this new
14 structure, an exemption for a non-enumerated hedge
15 in our markets we're, effectively, seeking to
16 extend that to positions that might held on an
17 over-the-counter basis.

18 And in that context, those
19 over-the-counter positions would be bound by that
20 larger number that we would be passing forward to
21 the CFTC. The CFTC staff would then have the
22 ability to, when looking at the totality of the

1 positions, because I think cornerstone I probably
2 should have put on there, and maybe it was
3 implicit to some, is that we are looking at
4 positions in our market, we are happy to look at
5 these exposures.

6 I don't see, Erik doesn't see the OTC
7 book on a regular basis, the Commission does. So,
8 with regard to those OTC positions where the
9 Commission would be monitoring for, you know,
10 limit purposes, let us say, in the spot month,
11 we've got limits in our markets, which we are
12 monitoring. They certainly could be looking at
13 that, they are also looking at, per the proposal,
14 various positions in physical or financial
15 buckets, and across them, as well as the OTC.

16 So, there is clearly a role here that
17 the Commission has to have in terms of the ongoing
18 surveillance of these markets, but we think we are
19 passing forward a valuable bit of information as
20 it relates to each of these prospective
21 non-enumerated exemptions.

22 Additionally all -- again, not only

1 approvals but obviously all denials would be
2 forwarded promptly to the CFTC. We've discussed
3 the prospect and reality of conducting regular
4 meetings, you know, with an eye towards -- we
5 think it can only be beneficial for the entities
6 who will be processing these, to look at these in
7 the same contextual way. Do we think that this
8 makes sense, so that we are as unified as we can
9 be in our thinking around this? An outcome that
10 wouldn't be great is that we are granting
11 something and recognizing it and someone else
12 isn't.

13 So, we would like to think we could get
14 further on the same page. We would seek to then
15 publish, on each of our respective website, a
16 summary of the type of non-enumerated exemptions
17 that we would have approved, and coordinate to,
18 I'll say, offer similar characterization. One of
19 the fears is the infamous tomatoes and tomatoes.
20 Someone says I'm doing X, X to me is a little bit
21 different than X to you, and there are likely
22 those circumstances.

1 So, we would, again, in the context of
2 our ongoing interaction to try and support this,
3 we try to communicate regularly such that, we are
4 characterizing things that we would have done in a
5 similar fashion. Consistent with what Ron had
6 said earlier, the CFTC through the Rule
7 Enforcement Review process, or at any other time
8 it deems necessary, can request from us any of the
9 underlying materials and documentation supporting
10 the approval or the denial.

11 And last and certainly not least, it
12 would be our view in this construct, that if in
13 fact we had this authority to grant this, did so,
14 and subsequently, you know, through the process
15 that I put forth earlier, the Commission sought at
16 some later date to review the materials and say,
17 you know what, through some interpretive process,
18 we don't agree that this particular non-enumerated
19 hedge should be allowed less some fraud or bad
20 faith, which wouldn't happen.

21 We have to have a safe harbor as would
22 the market participants, so that there wouldn't be

1 a look-back and say, you know what, the Exchange
2 made a decision, we don't like it, during this
3 period you were over the limits and it's a
4 position limit violation, and you are going to be
5 sanctioned for it. So if we had that authority
6 and administer this process, we'd both have a safe
7 harbor, unless, of course, a similar Act.

8 I think it would probably make some
9 sense, too, if we could put up that slide covering
10 the example. While I spoke to it, it might be
11 good to look at it on the board. So, an
12 application for a non-enumerated hedge exemption
13 is put forward to both CME and ICE. That
14 application, you know, by the participant for
15 whatever the strategy is, shows 8,000 futures
16 equivalent lots of exposure.

17 We conduct our analysis, and while we,
18 broadly speaking, agree, we look at that exposure
19 to be more like 6,000 futures equivalents. Based
20 on the market liquidity and other considerations,
21 we each granted 4,000 contracts. In that approval
22 letter to the participants we denote the

1 recognition of the six in total.

2 So, effectively that hedger my enter
3 6,000 lots of total positions on a combination of
4 either CME, ICE and the OTC but bound,
5 additionally, by the 4,000 that both ICE and CME
6 Group afforded. Anything else I missed?

7 CHAIRMAN MASSAD: Tom?

8 MR. LaSALA: Yes.

9 CHAIRMAN MASSAD: What happens if one of
10 you says, well actually I think you could have
11 8,000 but not more on -- no more than 5,000 on
12 either CME or ICE? Is the one who said the lower
13 limit bound by the -- or rather, it's one who says
14 the higher limit bound by the one who says the
15 lower limit?

16 MR. LaSALA: The participant would be
17 bound by the lower limit of the total exposure.

18 CHAIRMAN MASSAD: So, CME said, I
19 disagree with ICE, I really think you could have
20 5,000; but ICE said, no, no, no, 4,000, CME is
21 bound by the 4,000; the participant is bound by
22 the 4,000?

1 MR. LaSALA: No. Let me maybe try and
2 catch that. We are making independent decisions
3 with regard to a number on our market, I thought
4 and I may have misunderstood, that what you were
5 getting at was in, like this example, the
6 participant showed to each of us. I have this OTC
7 -- pardon me -- this non-enumerated exposure of
8 8,000. I thought what you were getting at is,
9 when I looked at it, I said, do you know what, I
10 really think that number is 4,000 and Erik, and
11 that would be embodied in my letter, and Erik
12 looked at that application, and said, no, no, no,
13 I really thought it's 6,000.

14 SPEAKER: Whatever.

15 MR. LaSALA: In that example, we would
16 say that the participant would be bound to the
17 lower determination before, however, the process
18 by which we communicate we would hope to strike
19 the same number on a regular basis. Much progress
20 has been made.

21 CHAIRMAN MASSAD: What happens -- Go
22 ahead, yes.

1 COMMISSIONER GIANCARLO: I'm not sure,
2 though, you answered the Chairman's question.
3 What if the same application goes to each of you
4 for a product which is on both exchanges which is
5 -- I have to think about that, but if you grant
6 different levels, what is the market counterparty
7 limited by?

8 MR. LaSALA: Each of us is effectively
9 recognizing two things, a level on our markets,
10 mine might be more liquid, I grant a larger number
11 on my market, his might be less liquid, so our
12 decision for the number on our market, is
13 independent. They are independent. His might be
14 larger and he says, I can handle 5,000 and I say,
15 do you know what, that's great, I can't. I can
16 only give you 3,000. The party has to respect the
17 boundary that I set up on mine, also respect the
18 boundary set up on his.

19 It may be that we are in agreement on
20 our analysis of the macro exposure that we pass on
21 to the Commission that then, the party can hold in
22 the aggregate across his exchange, my exchange as

1 well as the OTC.

2 COMMISSIONER GIANCARLO: So, without
3 digressing too much. Maybe the broader thought
4 is, as we go forward in examining this, whether
5 there are any opportunities for arbitrage between
6 the two exchanges that we need to think about.
7 The coordination when you think about whether --
8 for products that are fungible, whether there is,
9 perhaps, some arbitrage opportunity, and if there
10 is it needs to be addressed in any final approach.

11 MR. LaSALA: Okay.

12 CHAIRMAN MASSAD: Let me ask another
13 question. I think, Tom and Erik, in your
14 presentation, you talked about the exchanges
15 publishing some facts about the exemptions you are
16 granting.

17 MR. LaSALA: Correct.

18 CHAIRMAN MASSAD: In Ron's presentation
19 he noted the need for confidentiality; we also
20 have the issue of, if the Commission reviews
21 something, that would presumably be a public
22 process. Can you talk a little bit about how

1 quickly would you envision publishing something
2 relative to the granting of an exemption, and how
3 do we balance the issue of public entitlement to
4 know?

5 The concern Ron noted about the
6 individual participant's desire for
7 confidentiality, whether or not the Commission
8 reviews it, but if the Commission then reviews it,
9 don't all the facts become public?

10 MR. LaSALA: Let me clarify and respond
11 to your question from the exchange standpoint on
12 the publishing. What we would intend to publish
13 is by no means who received an exemption, but a
14 characterization of the type of non-enumerated
15 strategy that we each recognized. Again, trying
16 to make that -- those words as similar as possible
17 to be consistent, and we would do so, I'll use the
18 word, promptly.

19 CHAIRMAN MASSAD: What, with amounts?

20 MR. LaSALA: No. No amounts.

21 CHAIRMAN MASSAD: And then what happens?
22 What happens if the Commission then reviews

1 something?

2 MR. OPPENHEIMER: I mean, I think that
3 one is a little more for me, because when I talked
4 about the confidentiality, I guess, the hope would
5 be that the Commission would be reviewing
6 something as it would in the proposed rulemaking,
7 talking about a strategy as opposed to a
8 particular party's position or need.

9 The problem, and I think it's a good
10 point to focus on, is if the unique strategy can
11 be divined to be applicable to only one market
12 participant, and I'm not exactly sure what you do
13 in that circumstance, and it could present a
14 conflict.

15 CHAIRMAN MASSAD: But I guess you are
16 suggesting we would be publicizing the strategy
17 but not the amount, and yet, presumably, the
18 public's concern might be driven by the amount as
19 well.

20 MR. OPPENHEIMER: Well, I'm not sure
21 about that, and I'm not sure --

22 CHAIRMAN MASSAD: No? Okay.

1 MR. OPPENHEIMER: -- you know, what the
2 public's interest is in analyzing that even under
3 current structure. So, the strategy, for sure, if
4 it's going to be something that has precedent and
5 will be applicable to others, either if it's
6 granted or denied in the future, clearly an
7 interest in that, but currently if somebody either
8 -- and let's use the enumerated agricultural
9 products that the Commission already has oversight
10 from a position-limit perspective on, if somebody
11 takes a position in those markets, that's not up
12 for public debate as to whether or not that's
13 appropriate.

14 And if somebody applies for an
15 enumerated -- a non-enumerated exemption, excuse
16 me, under existing process for those products,
17 again it's not open for public debate as to the
18 size of the position that the Commission might
19 grant if they granted one of those exemptions.

20 MR. ALLISON: Let me just add to the
21 expression of concern about the need for
22 confidentiality. In the statute, when it talks

1 about reporting, it attempts to guarantee that the
2 identity of the entity reporting positions is kept
3 confidential, but that's details or transactions
4 that have already happened. In a sense they are
5 history, yeah, there are some concerns about
6 getting front runners as you try to hedge your
7 hedge, but that's history.

8 When we are talking about reviewing
9 these applications for exemptions, we are not
10 talking about history, we are talking about
11 business we intend to do going forward, and the
12 competitive value of that information is
13 dramatically higher. Now, I don't have the legal
14 answer to what all of the requirements are when
15 you review material, but you are dealing with
16 material that is of very high competitive value,
17 even more valuable than the historical data on
18 swaps that we have done, where the statute did
19 explicitly protect the anonymity of the reporting
20 party.

21 MR. COSGROVE: Tyson?

22 MR. SLOCUM: Thank you very much. So,

1 I'm Tyson Slocum. For those unfamiliar with my
2 organization, it's Public Citizen, we are a public
3 interest, nonprofit, consumer-advocacy group. So,
4 before us we appear to have a fairly significant
5 proposal that would, in essence, delegate some
6 Dodd-Frank functions to the private for-profit
7 exchanges, instead of having these activities done
8 by the Commission. So that's my understanding of
9 what this proposal -- No? That isn't what this
10 proposal is?

11 MR. HAAS: I think right now what we are
12 saying, is this version is not a delegation of
13 really anything to the exchanges. It's allowing
14 us to continue to do our current process, and the
15 CFTC passing some rule allowing the person who
16 receives an exchange exemption to utilize that for
17 -- an exchange exemption for non-enumerated
18 hedging, to potentially use that for OTC. The CFTC
19 would still have the responsibility to monitor for
20 that and manage that; all they are doing is
21 allowing us to continue our existing exemption
22 approval process, but I wouldn't classify it as a

1 delegation to us.

2 MR. SLOCUM: I see, but it is serving a
3 function within the position-limit regime, that
4 rather than have CFTC conduct a review of an
5 exemption, that would be, instead, handled by the
6 market surveillance staff of the exchanges. Is
7 this accurate?

8 MR. LaSALA: I'd say, initially that
9 that would be the case with the -- as we, again,
10 conceptualize the ability certainly for the
11 Commission to come in and modify, revoke, but
12 Tyson, again, remind you, and I think that the
13 numbers are probably similar for Erik, I guess
14 when you mention for profit, way more -- more than
15 double the amount of exemptions that are processed
16 by the Exchange are tuned down or denied.

17 So, we are bound, we are getting
18 rule-reviewed, this isn't about taking on a
19 process to expand our business model. In fact,
20 you know, we are exempting here, positions on our
21 market, but practically speaking we are setting a
22 boundary of positions that can be held outside of

1 our market in the OTC space.

2 So I just want to be clear, I don't see
3 -- I think the point you may be poking at with the
4 for-profit exchange. You've got the regulators
5 here, you've got a clear responsibility that are
6 getting rule enforcement reviewed on a regular
7 basis, who are owed to maintaining certain
8 standards, in that decision-making process, and
9 additionally you've got the Agency, clear
10 oversight, and an ability to revoke or evacuate
11 as they see appropriate.

12 MR. SLOCUM: So, just to understand. I
13 mean, the exchanges earn money through fees on
14 trading volumes of the greater the trader volume,
15 the greater the fees that you can collect, through
16 selling proprietary data and then selling
17 preferential access through collocation services
18 and things like that.

19 So the question I have is how exactly is
20 the independence of the market surveillance
21 offices maintained within your corporations? I
22 didn't see a real explanation of that in your

1 presentations.

2 MR. LaSALA: Sure.

3 MR. SLOCUM: I mean are there firewalls?
4 What are the --

5 MR. LaSALA: Absolutely! So, I'll speak
6 about my institution, and certainly let Erik speak
7 to his. There is absolute independence, number
8 one there are proprietary systems, there are risk
9 disclosures, the market surveillance, and just
10 market regulation team, and my institution doesn't
11 share public space with other areas of the
12 company. Strict confidentiality standards, yearly
13 disclosures, there is an absolute firewall as to
14 who gets access to data that is regulatory in
15 nature; absolutely, positively, unequivocally.

16 MR. SLOCUM: How is that firewall
17 enforced? What third party oversees that? Is
18 this an internal enforcement? Is there an outside
19 third party that enforces that absolute firewall?

20 MR. LaSALA: It not only is internal but
21 we have -- I forget, Bryant will tell me that --
22 internal, not internal affairs, what's it, Global

1 Assurance?

2 MR. DURKIN: Yeah. Internal Audits,
3 yeah.

4 MR. LaSALA: Internal Audits conducts
5 reviews of in fact, you know, the independence and
6 the integrity of that relationship.

7 MR. SLOCUM: So, just to be clear,
8 that's an internal enforcement? Is this a third
9 party entity?

10 MR. LaSALA: Internal.

11 MR. SLOCUM: So it's an internal
12 enforcement of a firewall? I'm not --

13 MR. LaSALA: And of course the CFTC
14 conducts Rule Enforcement Reviews that look at,
15 again, how we are structured, where we sit, and
16 I'm quite confident if the Agency felt there was
17 some ill with regard to how our confidentiality
18 structures were constructed, they'd be more than
19 happy to make those very public.

20 MR. COSGROVE: And actually I think we
21 have number of other questions here, so if there
22 is time we can come back to this, but I'd like to

1 recognize Ben.

2 MR. JACKSON: One other thing I'd add to
3 that is, as President ICE Futures U.S., that our
4 regulatory function and compliance function
5 doesn't even report directly to me, it actually
6 reports to what's our Regulatory Oversight
7 Committee, which is an independent set of Board
8 Directors that oversee that group. So, I have no
9 reach directly into that group, or visibility into
10 some of the concerns that you would have and being
11 able direct and, say, grant an exemption for this
12 person for X, Y, Z commercial reason.

13 MR. COSGROVE: Todd?

14 MR. CREEK: Todd Creek with ICAP Energy.
15 We serve as an intermediary in the futures market
16 as well as the OTC swaps market. So, we have a
17 very holistic view of the marketplace. What I
18 would like to say is that, just with what's been
19 implemented so far, we've definitely seen a
20 decrease in volume, a decrease in the number of
21 participants, and definitely a decrease of or a
22 widening of the bid-ask spread out the curve.

1 So, we are very concerned of what this
2 might do. Obviously if we implement these
3 position limits very uniformly without giving
4 control to -- I should say, having guidance from
5 the exchanges who know these markets very
6 intimately. So, one point I would like to make, I
7 know that a lot of the markets have converted from
8 swaps to futures, so we have to think about the
9 headroom necessary to accommodate these
10 participants as they make the conversion to
11 futures.

12 And I know that Commissioner Wetjen made
13 a comment about the ag market, specifically saying
14 how well that had functioned. What I might note,
15 and I'll ask Tom just to confirm this, it's my
16 understanding that in ags actually the position
17 limits were doubled in ags I believe in 2012,
18 specifically corn, for example. So, it doesn't
19 mean a market can't function just because you
20 increased the position limits. I think it's been
21 a success. I don't know if you have comment on
22 that.

1 MR. LaSALA: I think that, and I don't
2 remember the exact numbers, we did up the -- the
3 position limit hadn't been updated, in many years;
4 some of that got hung up frankly with the various
5 rulemaking proposals, but yes, I know we increased
6 the limit, I believe in the core. Todd?

7 MR. CREEK: Just one more comment, too,
8 I'd like to make. We are concerned about heat
9 rates. I know Ron said that we were not going to
10 address the cross-commodity hedges as part of
11 this, but I would like to note that in our
12 business we see that heat rates are an integral
13 part of the trading communities today. In fact,
14 we should take a look at what percentage that
15 represents, because clearly we are bringing
16 natural gas into the fold here under this.

17 And unless we exempt that, I think we
18 will materially impact the utilities, and I see it
19 every single day. This is how a large majority of
20 the electricity contracts or the utilities hedge
21 today, via heat rates, and it should be addressed.
22 I know that a number of the comment letters have

1 spoken to it, but I have yet to see any type of --
2 it specifically addressed, in any type of
3 enumerated hedge.

4 MS. PARIKH: Lopa Parikh with the Edison
5 Electric Institute. To date in our comment
6 letters we hadn't really discussed this proposal
7 of delegating to the exchanges; since that time
8 we've been talking about it amongst our membership
9 quite a bit, and we are very supportive of the
10 proposal and many of the concepts that have been
11 discussed today by the Commercial Working Group
12 and the Exchanges.

13 Especially for energy commodities as our
14 members are trying through the rule and the
15 implications, some of the record-keeping and
16 regulatory burdens that are associated with the
17 concurrent enumerated hedge proposal they find to
18 be very troublesome. They normally fall into three
19 primary categories. The first one would be, you
20 know, classifying each individual transaction to
21 try to figure out which bucket of enumerated hedge
22 they fall into, and possibly developing new

1 systems to track these.

2 There's also some conversion issues, and
3 also issues with the forms itself, because OTC and
4 power products don't necessarily fit neatly into
5 any of the fields. And so because of that,
6 expanding on the successful exchange process that
7 was just discussed is very attractive to a lot of
8 our members, and so we would encourage the
9 Commission to continue the discussion on how that
10 would work, and possibly delegating more to the
11 exchanges rather than having enumerated hedges.

12 In terms of OTCs, we are also
13 comfortable; many of our members use OTCs and
14 don't use exchanges at all. And so in discussing
15 that with our members, they are comfortable with,
16 you know, having some percentage -- of managing
17 some percentage of their OTC contracts to the
18 exchange limits and then notifying the Commission,
19 you know, when they would go above that threshold.

20 And so that would, you know, kind of
21 provide the Commission with transparency in the
22 process, but still have our membership to continue

1 in the hedging that they currently do in order to
2 meet their customers' needs. And so, you know,
3 we've outlined a full process which I'm happy to
4 discuss in more detail which is very similar to
5 what the Commercial Working Group has put forth, I
6 think it maybe expands on that process a little
7 bit, but I just wanted to express some of our
8 concerns with the proposed rule in terms of the
9 burdens that it places on our members, and why
10 this delegation proposal is attractive to us for
11 that reason.

12 MR. GILL: Thanks Mike. I guess a quick
13 process question, I think the Chairman answered
14 this, but just to be sure, this concept obviously
15 would be some something that would be re-proposed
16 and put out for public comment?

17 CHAIRMAN MASSAD: Well, I'll defer
18 ultimately to our lawyers and other staff, but my
19 own view would be that if we were to go down this
20 road, it's important to make sure we have a
21 process where the public can comment. And so I
22 would envision -- I would support at least doing

1 it in a way when on this aspect of the rule, we
2 take further comment.

3 MR. GILL: Thank you. And, just a quick
4 comment on that; Commissioner Giancarlo earlier
5 referenced farmers and ranchers and concerns over
6 the drop in commodity prices. Independent
7 producers of oil are also aware of a drop in
8 commodity prices, and therefore sensitive to
9 limitations on hedging strategies and other --
10 limitations on liquidity, and recognizing, as
11 Commissioner Bowen said, this rule has been out
12 there.

13 I also think that folks, this Committee
14 seems to be moving more toward the concept of how
15 to implement position limits, rather than the old
16 argument of whether position limits are in fact
17 needed. And therefore, to me, it's still within
18 the congressional -- the spirit of congressional
19 intent.

20 These types of concepts being proposed,
21 I would not view it as sort of a delay on it, but
22 rather, this is really in the forward momentum to

1 getting towards a regime that is workable for the
2 community, and I think you may get groans if there
3 is a -- certain segments are re-proposed, but in
4 the long term, I think that, you know, the
5 discussion and the viewpoints are such that there
6 seems to be some still problems to be worked out.

7 And if we can engage the expertise of
8 the exchanges to make this work better, then there
9 ought to be a prudent course, and taking a little
10 grief on another proposal, it may be worth it.

11 MR. COSGROVE: Tom, did you want to
12 respond to any of these comments?

13 MR. LaSALA: I wanted to just follow up
14 on a point that Lopa made, because she reminded me
15 of something critical that I neglected to mention.
16 We spoke very -- especially me in terms of the
17 process, we spoke about the applicants coming to
18 the exchange, applicants that maintained
19 positions, on our exchange, or transacted, cleared
20 with us. What I didn't address was, what might be
21 processing of a request for a non-enumerated hedge
22 by someone that doesn't touch one of us.

1 And I put it out to this group, that we
2 are willing to, and we've had some discussion to
3 talk about how we could do that. Frankly one of
4 the issues is, and it goes back to the resource
5 issue, I don't know how big it is. I think we'd
6 have to have some type of a dialogue with the
7 Commission based upon the data that they are in
8 possession of, to get some kind of context of what
9 that looks like, because I just don't know.

10 I don't know if there are two people, or
11 if there are 63 people that we don't deal with
12 today that would be wanting to come to us, and it
13 goes to, how do we potentially support and
14 resource that. So, I think we are open-minded to
15 want a dialogue around that further and
16 prospectively, entertain that, but we need some
17 more information, and so we'd be anxious to speak
18 with you.

19 MR. COSGROVE: Jim?

20 MR. ALLISON: A question for Tom, going
21 back to your impact presentation, so back to the
22 beginning of the morning.

1 MR. LaSALA: Yes.

2 MR. ALLISON: So, if I understood you
3 correctly, you talked about your targeted
4 concentration limits on the accountability tests,
5 and you said something like, the further out you
6 go on the curve, the greater your tolerance for
7 concentration. Is it reasonable to conclude from
8 that, that the threat of excessive speculation is
9 less outside the spot months than within the spot
10 months, and in fact that threat declines the
11 farther out the position is?

12 MR. LaSALA: I think that, Jim, that
13 would be our position. And I'm not going to, say,
14 dismiss it completely, but as you go further out
15 the curve, it's more difficult. And again, I'm
16 not saying that someone couldn't have substantial
17 positions across the entire curve and become a
18 concern for us, but outliers in various months,
19 you know, basically pose less of a concern for us.
20 And again, where we see those, assuming they are
21 through our thresholds, we are addressing them.

22 MR. COSGROVE: Dena?

1 MS. WIGGINS: Dena Wiggins with the
2 Natural Gas Supply Association, and I just wanted
3 to comment that we have in past comments filed
4 here at the Commission supported a greater for the
5 exchanges and very much appreciate the work that
6 ICE and CME and Ron's working group have put into
7 this proposal. Looking forward to continuing to
8 work within this process here at the Commission to
9 address some of the details that have been brought
10 up about. I think Jim appropriately pointed out
11 confidentiality is a huge concern of keeping the
12 details of these transactions, or these proposed
13 transactions confidential, but very much look
14 forward to continuing to work on this, because we
15 think it's a good idea to have the exchanges
16 involved in this.

17 MR. COSGROVE: Vince?

18 MR. JOHNSON: Vincent Johnson, BP. Tom,
19 I had a quick question, a process question to
20 follow up with you around the process, so if --
21 would you say -- I think you were making
22 statements around having the enumerated hedging,

1 the ability to make the decisions and then CFTC to
2 look at that. But if BP comes and we get approval
3 for a numerated hedge exemption, three months
4 later, we are taking on risks, we are hedging sort
5 of a -- a new business practice.

6 And then the Commission, six months
7 later, the Commission comes and the Commission,
8 not because of bad data, but because of a
9 difference in interpretations and they disagree,
10 I'm just wondering how that works, so we set up a
11 process relying on what you approved, how would
12 that work; and your thought?

13 MR. LaSALA: My thought would be that,
14 if the Commission through that process ultimately
15 determined that that strategy was not allowable,
16 we would have to set up some kind of a structure
17 to talk about how to -- Again, if they are in
18 excess -- if that in its totality is in excess of
19 a would-be limit. Talk about some type of an
20 orderly liquidation. Or, realize that those
21 positions would have to be warehoused within the
22 allowable spec limit.

1 So, if it was, again, if you were over
2 with regard to that strategy, yes, there is an
3 impact, where, I think we would have to talk about
4 an orderly liquidation. Not so dissimilar,
5 frankly, from the point that Ron touched on.
6 Market circumstances change, markets change,
7 someone put on positions. There is a significant
8 contraction in the open interest profile. We are
9 concerned about the concentration.

10 We talk with folks about how to -- in an
11 orderly fashion. We are not looking to harm
12 people but we've got to get to a certain point, so
13 yes, we think we'd have to work through that,
14 Vincent.

15 MR. COSGROVE: Russ?

16 MR. WASSON: Russ Wasson, with the
17 National Rural Electric Cooperative Association.
18 You know, we filed a comment letter, and it's our
19 position that entities that don't speculate, they
20 should be granted exception under 4a(a)(7). You
21 know, the Commission should use jurisdiction to
22 grant that exemption, and the reason, it's because

1 of exactly what Lopa mentioned when she talked
2 about cost.

3 Costs are absolutely critical to our
4 members. And I don't know how many of you saw the
5 New York Times article that came late last night,
6 which said that the President's climate plan, the
7 Final Rule may come out on Monday. But in
8 conjunction with looking forward to that, which is
9 probably going to increase the costs of everyone
10 in this room, to some degree or another, we
11 conducted a comprehensive econometric study of
12 rural America and the 42 million people we serve
13 in rural America.

14 And we determined that a 10 percent
15 increase in the price of electricity, which to us,
16 doesn't see like that much, to our members would
17 result in the loss of 500,000 jobs in rural
18 America, but it would take us 20 years, given
19 current growth rates in rural America, to recoup
20 the economic benefits of those 500,000 jobs that
21 were lost.

22 So, we have approximately 5.5 million

1 people out of those 42 million that I mentioned
2 whose annual income is \$25,000 or less. So to
3 them, a 10 percent increase in the price of
4 electricity is not a problem, it's a tragedy.
5 Because they have to make a decision about what
6 are they going to do? Are they going to spend
7 that money on food or medicine? Are they going to
8 pay their power bill?

9 And so, if we are going to use the
10 Position Limits Rule to regulate the hedging of
11 commercial end users who are hedging their ongoing
12 operational risk, and forcing us to go get the
13 thousands and thousands of hedges we do along
14 those lines enumerated and exempted, that's going
15 to substantially increase our cost of operations,
16 and on top of everything else going on, it's going
17 to put a great deal of pressure in the countryside
18 and rural America where our members provide power.

19 MR. COSGROVE: Paul?

20 MR. HUGHES: Paul Hughes with Southern
21 Company. I don't want to get us off track, but I
22 do want to make a couple of points and see what

1 you guys think about this. We have been talking
2 about position limits, and my assumption has been,
3 is that everybody is assuming that when we talk
4 about limits, and we talk about positions, that
5 would not include anything that would be
6 physically -- intended to be physically settled or
7 would be a trade option.

8 We'll also have a panel later this
9 afternoon, and I'm not trying to jump ahead, but
10 when you asked the question, you said, you are not
11 really sure how big that OTC market is. Depending
12 on how we answer that question, of what is in the
13 population, if it includes contracts that are
14 intended to be physically settled, it's a very
15 different answer. And so, that's a little bit of
16 a statement, I guess my question would be, in all
17 of our discussions so far, are we kind of stating,
18 hey, we are making an assumption that those
19 contracts would not be included in the analysis
20 we've been talking about.

21 MR. HAAS: I don't think we are
22 considering what happens with trade options, and a

1 bunch of those becoming swaps or not, we are
2 thinking right now, just what would be out there
3 as defined as your swap business.

4 MR. LaSALA: Your swap business. And
5 from the physical bucket, if you will, we were
6 thinking that those trade options would look more
7 like forwards.

8 MR. OPPENHEIMER: And that's what our
9 comment letter has suggested as well.

10 MR. COSGROVE: Okay. I know there may
11 be another question or two, we've run, I think,
12 very, very thoroughly and well through this topic.
13 I'd love to thank our panelists, and everyone for
14 questioning. We are going to take a 15 minute
15 break now and start again at 12 o'clock.

16 (Recess)

17 MR. COSGROVE: Okay. Welcome back
18 everyone. Our second panel will be discussing a
19 phased approach to position limits, and I'm going
20 to let each of you introduce yourselves briefly,
21 and then begin, and we are very interested to hear
22 what you have to say.

1 MR. BOURGEOIS: Y.J. Bourgeois, with NRW
2 Petroleum on behalf of NGSA today.

3 MR. McCOY: Bill McCoy, I'm here
4 representing the Futures Industry Association.

5 MR. BERGER: Stephen Berger from
6 Citadel; I'm here on behalf of the Managed Funds
7 Association.

8 MR. McCOY: Okay. I think I've been
9 asked to lead this discussion off. And first of
10 all, on behalf of Anadarko, and NGSA, I wanted to
11 thank CFTC and EEMAC Advisory Committee for this
12 opportunity to present an end-user's perspective
13 on position limits especially relative to natural
14 gas.

15 As the CFTC considers rulemaking in
16 regards to exchange trader position limits, it may
17 be useful to consider how a typical end-user
18 navigates these limits currently, and impacts our
19 business operation.

20 Anadarko is one of the world's largest
21 independent producers, with approximately 2.9
22 billion barrels of oil reserves and proves as at

1 December 2014, and 2014 sale of 2.6 bcf a day of
2 natural gas, and over 400,000 a day -- 400,000
3 barrels a day of oil and NGLs. We have our asset
4 portfolio that's diversified with U.S. onshore
5 plays, deepwater Gulf of Mexico, and an
6 exploration of additional activities worldwide,
7 including places like Mozambique, Algeria, Ghana
8 and Brazil.

9 The company's most significant market
10 risk relates to prices for natural gas, oil and
11 NGLs. As energy prices decline or rise
12 significantly, revenues and cash flows are
13 likewise affected. As such the company does
14 actively use derivative instruments to reduce the
15 price risk associated with future production, as
16 well as to manage midstream and marketing
17 activities derived from various processing,
18 transportation, storage and purchase and sales
19 arrangements.

20 There are a number of broad issues
21 discussed today with the current Position Limits
22 Rule that are of concern to Anadarko, including

1 accurate deliverable supply determination, limits
2 being set at artificially low levels, and the
3 relative inflexibility and narrow scope of
4 enumerated bona fide hedge categories.

5 But today we'll focus our comments on
6 the spot month issues. More specifically, the
7 first step of the path forward is the need to
8 focus on appropriate spot month limits, to ensure
9 the continuance of sufficient market liquidity
10 which is critical to price discovery and the
11 orderly convergence of spot month futures and cash
12 prices.

13 Via the exchanges we currently have a
14 robust LSI process as you heard about earlier,
15 designed to ensure an efficiently market. We
16 further suggest that energy markets are currently
17 achieving a highly-effective price discovery
18 process, and believe any position limit changes by
19 the CFTC should look to maintain if not foster
20 energy markets.

21 This efficiency can be seen in how
22 readily the physical and financial markets

1 converge each month. Importantly, this
2 convergence dynamic held true during the
3 struggling 2008 financial crisis, we were in the
4 midst of a sharp run-up in natural gas prices and
5 a quick and sure and dramatic price decline, all
6 while financial system was in disarray, the
7 natural gas market continued to converge tightly
8 with the physical market.

9 Not only is this a compelling argument
10 as to how well the price discovery process
11 functions, but also supports why the current focus
12 should be on the spot month issues, as outer
13 months do not undergo the same crucial cash to
14 futures convergence process. This market
15 efficiency and integrity should absolutely be
16 preserved as any new regulations are implemented.

17 As noted in previous NGSAs comments, the
18 initial focus of the Commission should be centered
19 on the spot month physically-settled futures
20 contract, where the greatest potential for market
21 manipulation, if any, naturally resides due to the
22 physical delivery mechanism.

1 Financially settled contracts have
2 historically posed very little potential for
3 manipulation and should therefore have the benefit
4 of much higher limits. To this end, we suggest
5 the following. An accurate determination of
6 deliverable supply to determine the appropriate
7 level of spot month limits for physical futures.
8 Our view is consistent with NGSAs in that position
9 limits should be closely aligned with physical
10 deliverability.

11 The methodology currently put forth by
12 CME utilizing physical receipt and delivery
13 capacities, including backhaul capacity at Henry
14 Hub, suggest upwards of 5.7 bcf a day of
15 deliverable capacity exists. Taking 25 percent of
16 the capacity as proposed in the current
17 regulations would equate to roughly 4,245
18 contracts at the spot month limit; far above the
19 existing 1,000-contracts spot limit, which
20 represents only 6 percent of the current Henry Hub
21 capacity.

22 With respect to spot month limits on

1 financially settled contracts, although we agree
2 with having limits on physically settled futures
3 that are correlated to physical deliverability,
4 spot month limits on financially settled futures,
5 if any at all, should be based more on a
6 percentage of open interest.

7 In other words, establish financially
8 settled limits as a function of the financial
9 demand, and reflected by open interest, rather
10 than an artificial threshold. Also limits, the
11 financially settled contracts should not be
12 contingent on having a zero position in physical
13 futures, which would unnecessarily drain liquidity
14 from the physical futures market.

15 In addition, this will support
16 larger-sized positions to be held in the
17 financially settled contracts as opposed to
18 physically settled contracts, posing much less
19 potential for price manipulation via short
20 squeezes and/or market cornering.

21 And thirdly, we support the Commission
22 utilizing a phased-in approach for implementing

1 position limits. We believe the initial effort
2 should concentrate on the spot month issues as we
3 and others are discussing today. To help foster
4 market liquidity and healthy function, a measured,
5 phased-in approach will afford the Commission a
6 valuable opportunity to evaluate and assess the
7 effects of new regulation over time to guard
8 against potential ill effects or unintentional
9 consequences in the critical spot month.

10 Further to this point, it is our view
11 today that the exchanges are doing an excellent
12 job of monitoring and administering limits to
13 assure orderly market participation. The
14 exchanges today already require conformance to
15 non-spot- month limits utilizing the outer-month
16 accountability levels that you heard discussed in
17 the prior panel.

18 This role could conveniently continue as
19 any new spot regulations are implemented to
20 provide the Commission the time needed to allow
21 for a phased-in approach. After the successful
22 implementation of the physical -- of the initial

1 phase; a second phase can be initiated to address
2 non-spot month limits and associated issues with
3 the benefit of information gained in the initial
4 phase.

5 In closing, it is extremely important
6 for Anadarko to continue to utilize financial
7 markets to hedge its commodity price risk. It is
8 imperative that we maintain the ability to execute
9 hedging programs as needed, and the essential keys
10 to this are healthy, liquid, transparent and fully
11 functional marketplace.

12 The potential inability or difficulty to
13 execute our hedging programs due to restrictive
14 position limits, burdensome regulations or
15 cumbersome restrictions pose serious financial
16 concern to Anadarko and our shareholders. We urge
17 the Commission to consider these issues along with
18 industry input and participation to achieve a
19 regulatory framework that has appropriate
20 oversight while allowing for a liquid and
21 efficient market. We firmly believe both can be
22 achieved.

1 MR. McCoy: Good morning. Thank you for
2 asking FIA to participate in today's meeting, and
3 in particular for the opportunity to comment on a
4 phased approach to position limits. We support
5 the Commission's efforts to foster competitive and
6 efficient markets and believe this forum will help
7 accomplish this goal.

8 Broadly speaking, we remain concerned
9 that the position limits -- that the proposed
10 position limits may disrupt markets and ultimately
11 do more harm than good. As set forth in our prior
12 comment letters, we hope the Commission will
13 reliably assess whether the proposed limits are,
14 in fact, necessary before imposing new limits. In
15 our view the assessment should be based on
16 quantitative data that empirically supports the
17 adoption of new limits.

18 Only then can we be sure that we are not
19 putting the cart before the horse, so to speak,
20 imposing significant costs and barriers on market
21 participants without discernible benefits. If,
22 however, the Commission decides to move forward

1 with the proposed limits, FIA recommends adopting
2 the limits in phases, starting with the spot month
3 limits, and then addressing non-spot month limits
4 as necessary and appropriate in a separate
5 rulemaking.

6 A phased-in approach would have a number
7 of significant benefits, including: first,
8 allowing market participants time to comply with
9 the applicable limits; second, focusing the
10 regulatory efforts on the spot month, where the
11 markets are most active.; And third, permitting
12 the Commission time to consider and modify the
13 position limits regime as it develops and takes
14 shape.

15 The FIA recommends that the first phase
16 be limited to spot month position limits for the
17 28 Core Reference Futures Contracts. Most of the
18 proposed Core Referenced Futures Contracts already
19 have a CFTC or exchange-set spot month position
20 limit, and as a result market participants have
21 some experience monitoring futures contracts
22 towards the spot month speculative position

1 limits.

2 FIA expects significant implementation
3 issues among our members that necessitate a
4 transition period to come into compliance with new
5 Federal spot month position limits. For example,
6 the current set limits -- the current exchange-set
7 limits only apply to futures contracts. Market
8 participants will need significant time to develop
9 systems to incorporate swaps positions toward a
10 speculative position limit.

11 In addition, the CFTC administers
12 speculative position limits differently than the
13 exchanges. For existing CFTC-set position limits
14 on agricultural futures contracts, the CFTC
15 imposes regular reporting requirements for bona
16 fide hedging positions, whereby market
17 participants file monthly reports to the CFTC
18 identifying cash market positions that serve as a
19 basis for bona fide hedging positions.

20 The CFTC's proposed position limits for
21 futures and swaps in energy, metals and
22 agricultural commodities includes reporting

1 requirements similar to the existing CFTC rules.
2 In contrast, the exchanges typically do not
3 require the submission of monthly reports. Rather,
4 as we heard somewhat this morning, a market
5 participant applies to the Exchange for a hedge
6 exemption.

7 In some cases the Exchange, in its
8 discretion, may grant that for up to a year,
9 though as we heard the Exchange may revisit it
10 throughout the course of that year. But market
11 participants will need time to get accustomed to
12 the monthly reporting regime under the Federal
13 Administrative structure.

14 After the Commission adopts and gains
15 experience implementing Federal spot position
16 limits, as part of the first phase, the Commission
17 should reconsider position limits outside the spot
18 month, and specifically whether they are
19 necessary. The Commission should address non-spot
20 month positions as part of a later and separate
21 rulemaking proposal, which obviously will have the
22 benefit of additional comment as various market

1 participants gain experience with the
2 implementation of the first phase.

3 As FIA has commented in the past, and
4 both CME and ICE described at the last EEMAC
5 Meeting in February, liquidity for energy products
6 generally decreases further out in the curve;
7 because of the limited liquidity available in
8 deferred months, the Commission should take
9 particular care, first to find that position
10 limits outside the spot month are necessary, and
11 that the levels of any limits are appropriate.

12 In determining whether levels are
13 appropriate, it is important that the Commission
14 use and consider open interest data that is both
15 comprehensive and accurate with respect to both
16 futures and swaps. The Commission should evaluate
17 all the relevant and current open-interest data
18 for each reference contract and should further
19 rely on the OTC swap data reported to the SDRs and
20 swap data reported directly to the Commission
21 under Part 20.

22 If the Commission uses open-interest

1 data that is too narrow or inaccurate in setting
2 the limits, it runs the real risk of unduly
3 restricting liquidity for bona fide hedgers, or
4 negatively impacting the price discovery function.

5 Now, this phased approach offers a
6 variety of benefits to both market participants
7 and to the Commission. For example, after the
8 Commission adopts spot month position limits as
9 part of Phase 1, the Commission could focus its
10 limited resources on the administration of spot
11 month limits.

12 As the Chairman has made clear
13 previously, the CFTC is currently under-funded, so
14 it should focus its resources on the spot month
15 position limits, where large positions present
16 potentially a greater threat of excessive
17 speculation or even the risk of manipulation than
18 do positions further out in the curve.

19 The Commission's staff could continue to
20 collect the data and analyze the data regarding
21 futures and swaps positions further out in the
22 curve in order to determine whether position

1 limits are necessary and whether any proposed
2 position limits are appropriate.

3 The initial phase for spot month
4 position limits could provide market participants
5 time to adjust to the new position limits regime
6 for the most liquid part of the curve, the spot
7 month. In addition, the Commission's staff could
8 evaluate its definition of bona fide hedging for
9 purposes of the spot month limits and make
10 appropriate adjustments if the Commission
11 determines to impose non-spot month limits.

12 In short, a phased approach would allow
13 the Commission to calibrate the hedge exemptions
14 as the position limits regime develops. As FIA
15 has commented in the past, the Commission's
16 proposed definition of bona fide hedging is overly
17 narrow and may further decrease liquidity outside
18 the spot month. If a hedger's positions are
19 classified as speculative, its activity is now
20 subject to a cap that reduces liquidity.

21 Further, if a hedge's position does not
22 qualify as a bona fide hedging position, a dealer

1 in the OTC market may be less willing to provide
2 liquidity to the hedger because the dealer cannot
3 rely on the pass-through swap exemption to hedge
4 its swap position with the hedger. Because
5 liquidity is already limited out the curve, the
6 Commission should ensure that it establishes an
7 appropriate definition of bona fide hedging
8 positions. Otherwise, the Commission risks
9 unnecessarily limiting liquidity for bona fide
10 hedgers outside the curve.

11 If the Commission expands the list of
12 enumerated hedges and adopts an efficient process
13 to recognize non-enumerated hedges for purposes of
14 the spot month's limits in Phase 1, the Commission
15 could further expand the definition before it
16 proposes any non-spot month position limits in the
17 second phase.

18 Now, as part of this phased approach the
19 Commission should evaluate the use of position
20 accountability levels outside the spot month as
21 opposed to hard limits. In connection with the
22 last EEMAC meeting FIA submitted a comment letter,

1 explaining that position accountability levels do
2 represent a form of position limits, and that the
3 Commission has the authority to impose position
4 accountability levels outside of the month.

5 So, after imposing spot-month limits in
6 the first phase, the Commission could evaluate the
7 appropriateness of accountability levels instead
8 of hard limits outside the spot month. In
9 addition to conserved Commission resources, the
10 Commission could evaluate and propose an
11 appropriate framework to employ the administration
12 of accountability levels at the exchange levels.

13 Finally, I'd like to talk about the
14 authority of the Commission to adopt a phased
15 approach, as between the spot month and the
16 non-spot month position limits. As Commissioner
17 Giancarlo noted in his opening remarks, a phased
18 approach has been used by the CFTC before in
19 implementing clearing. We've also -- phased
20 approaches have been used in the context of
21 reporting and SEF trading.

22 Also, in its prior rulemaking with

1 respect to position limits, in CFTC Regulation
2 151, the Commission explained that it had the
3 discretion to phase in position limits for all
4 physical commodity futures contracts and
5 economically equivalent swaps but chose
6 appropriately to start with the 28 Core Reference
7 Futures Contracts.

8 Because the Commission has discretion in
9 its rulemaking to phase in various types of
10 rulemaking, the Commission has this discretion to
11 phase in spot month and then non-spot month
12 position limits. In addition, the Commission can
13 rely on its exemptive authority in Commodity
14 Exchange Act Section 4a(a)(7) to exempt non-spot
15 month positions from speculative position limits
16 during Phase 1 and thereafter determine whether to
17 establish position limits outside of the spot
18 months.

19 On behalf of FIA, again, I would like to
20 thank the Commission for allowing us to provide
21 these opening remarks and entertain any questions.

22 MR. BERGER: On behalf of MFA, I would

1 also like to thank the Commission for hosting
2 today's meeting and thank the Committee for
3 providing us with the opportunity to address you
4 all today.

5 For those of you who aren't familiar,
6 MFA represents the global alternative investment
7 industry, including hedge funds, managed futures
8 firms and their investors, by advocating for sound
9 industry practices and public policies that foster
10 efficient, transparent and fair capital markets.

11 MFA members help pension plans,
12 university endowments, charitable organizations,
13 qualified individuals and other institutional
14 investors to diversify investments, manage risk
15 and generate attractive returns.

16 As investors in the commodity markets,
17 MFA members play an essential and beneficial role.
18 The research and analysis that we provide and
19 express in the marketplace leads to greater
20 transparency, more efficient economic
21 decision-making by producers and consumers as a
22 result, and we believe it helps optimize resource

1 allocation in the real economy.

2 The market activity of MFA members
3 enhances liquidity and facilitates the price
4 discovery process; we believe this helps normalize
5 prices of commodity futures at different
6 maturities and dampens price volatility. These
7 market efficiencies help producers and consumers
8 with their risk-management needs and help inform
9 forward capital investment resource allocation
10 decisions.

11 The ability of investor capital to take
12 long and short positions and bring new information
13 to the marketplace helps foster deep, liquid, and
14 efficient commodity futures markets. Limiting
15 legitimate activity undermines all these benefits.

16 MFA believes that any rulemaking on
17 position limits should be empirically driven and
18 not based on partial analyses. Further, we are
19 concerned by a one-size-fits-all approach and have
20 specific concerns in the context of the energy
21 markets that using an approach that's worked for
22 the legacy agricultural contracts may not at all

1 be appropriate for energy markets.

2 We don't believe there's been an
3 adequate necessity finding yet established with
4 respect to establishing position limits, but want
5 to present nonetheless here today our proposal for
6 how to phase in any position limits if the
7 Commission does go ahead and go down that path.

8 MR. SUTARIA: Stephen, can you just get
9 a little closer to the mic, please?

10 MR. BERGER: Sure. No problem. In
11 short, we believe, and I think it mirrors closely
12 what you've heard from my fellow panelists, that
13 the CFTC should adopt position limits and position
14 accountability measures through a two-phased
15 rule-making approach. Phase 1 of that approach
16 would focus on adopting spot month position
17 limits.

18 Of course, I think the corrections that
19 Y.J. importantly noted still need to be made to
20 that proposed regime. That process could also
21 involve finalizing the Commission's approach and
22 definition with respect to bona fide hedging

1 transactions and during that first phase would
2 provide the opportunity to rely on and review data
3 from the Exchange position accountability regime
4 for the non-spot months.

5 Then in Phase 2 a separate rulemaking
6 could be undertaken to adopt position
7 accountability levels for non-spot months based on
8 further informed data that's gathered during Phase
9 1. We believe that the key benefits of a
10 two-phased rulemaking approach is that it would
11 provide the CFTC with more time to gather accurate
12 data and reliable data, and it would also minimize
13 unintended consequences, decrease the risk of
14 market disruption and afford the Commission,
15 again, better data on which to base non-spot month
16 position accountability levels.

17 We believe that the position
18 accountability regime for the non-spot months
19 would strike a better balance between ensuring
20 effective oversight of the markets while also
21 preserving liquidity and the efficiency of the
22 price discovery process. We think that the

1 position accountability regime as I think earlier
2 panelists have mentioned does have teeth. There
3 is the ability to put limits on market
4 participants from further increasing their
5 positions or call on market participants to reduce
6 their positions as necessary. And I think, again,
7 the exchanges have already outlined this well.

8 We believe that the two-phased approach
9 that we proposed would address a number of
10 concerns that MFA has outlined. The first, again,
11 being that the CFTC's proposed limits are based on
12 incomplete data. We believe, I think, as everyone
13 in this room does, that position limits should be
14 based on accurate and up-to-date data, both on
15 deliverable supplies with respect to the spot
16 month, and open interest across both futures and
17 swaps with respect to any non-spot month limits.

18 But, you know, having that full data set
19 is going to take time to further gather, and in
20 addition, until the bona fide hedging definition
21 and approach is finalized, the classification
22 going forward of what's going to be hedging versus

1 speculative activity, you know, breaking that
2 dataset down won't happen.

3 We believe that the approach would also
4 address our concern that the proposed position
5 limits are miscalibrated and have been set too
6 low. I was particularly intrigued by the
7 presentation in the first panel from Tom LaSala of
8 CME, because I think he gave a much more granular
9 investigation of the data that the Commission put
10 forward in Table 11-A of the February 2015
11 release.

12 You know, when we at MFA looked at that
13 table, we were very concerned about the number of
14 participants that it identified as already being
15 near, at or above the proposed limits, and we
16 don't believe that -- you know, we think that's
17 indicative of the fact that the proposed limits
18 would restrict legitimate market activity. We
19 don't believe that the CFTC has found or made a
20 finding that there's excess speculation at the
21 limits that are proposed, so that leads us to
22 conclude that either the data is incomplete or

1 that the methodology is wrong, or perhaps both.

2 So, position accountability would
3 certainly provide a much better regime and a much
4 more flexible regime to investigate, you know, why
5 there are so many people at or above the limits
6 that have been proposed and, you know, what's
7 driving that, and how that can be addressed.

8 I want to take a minute to just, you
9 know, look at, again, I think one of the points we
10 made upfront was that the one-size-fits-all
11 approach may not be appropriate across different
12 commodity markets, and so when we look at the
13 proposed limits that have been put forward for
14 certain of the energy contracts in the non-spot
15 month, we see a proposed non-spot month limit for
16 crude of 109,000 contracts, but for gasoline
17 11,800 contracts.

18 And then we look at that in comparison
19 to what the actual demand in the marketplace is
20 for those two commodities and you'll see for crude
21 in the U.S. it's about 16 million barrels per day
22 while for gasoline it's about 9 million barrels

1 per day.

2 So the discrepancy that struck us in
3 that context is that you have a limit for crude
4 that is 10 times that of gasoline but in actual
5 real demand in the marketplace for the product,
6 there's a 2 to 1 differential. So there appears,
7 in your view, to be a massive or significant
8 miscalibration of where the proposed limits are
9 versus the underlying supply and demand
10 fundamentals in the marketplace.

11 Further, the energy markets are
12 undergoing a period of dramatic change. Over the
13 last five years, particularly U.S. exports of
14 distillates and gasoline have grown significantly
15 to nearly 2 million barrels per day. We believe
16 that results in increased demand for refiners to
17 hedge distillate and gasoline production, and
18 that, you know, disproportionately low limits for
19 those contracts is going to impair the liquidity
20 and ability of that market to function.

21 So I think, you know, that points
22 further to the fact that a one-size-fits-all

1 approach is not going to be effective, and that we
2 need to take a two-phased approach to calibrate
3 things appropriately for the non-spot month limit
4 and to understand what approaches are appropriate
5 for different types of community markets.

6 In particular, again, just importing a
7 methodology that has been in place for the legacy
8 agricultural contracts may not at all be
9 appropriate for the energy markets. In MFA's view
10 the energy markets are more global, the products
11 in them are more fungible, the overall supply is
12 significantly larger, there's much less
13 seasonality in terms of production and the energy
14 markets are much more subject to macro
15 developments that affect prices and liquidity in
16 the markets.

17 In addition, the nature, and I think as
18 others have pointed out already, in terms of where
19 open interest is concentrated, whether it's just
20 in the first few months out, which tends to be
21 typical in the agricultural markets, versus up to
22 60 months out in the energy markets. So the

1 nature of where the open interest is and how it's
2 distributed along the curve is significantly
3 different in the two markets.

4 One last point I wanted to make, in
5 closing, relates to whether there's the
6 appropriate authority to pursue a phased approach,
7 and MFA believes that there clearly is. Both the
8 CEA and the Dodd-Frank Act, you know, reference
9 that the Commission may impose limits as
10 appropriate, and that also there is a requirement
11 for a necessity finding to be done.

12 So, if it's inappropriate to impose hard
13 position limits outside of the spot month, or if
14 there is not a necessity finding that that's
15 necessary, it's seems pretty clear-cut that more
16 tailored approaches could be taken to phasing in
17 position limits.

18 Again, thanks for providing MFA the
19 opportunity to address the Committee today. Thank
20 you.

21 MR. COSGROVE: I'm going to -- I have a
22 couple of questions I'd like to start with, and

1 then if anyone else has a question please put your
2 name up, like that.

3 For Y.J., I'm curious to know if
4 Anadarko has any activities that you would
5 classify as speculative?

6 MR. MCCOY: Not per se. You know, given
7 the portfolio of assets that we have, we typically
8 try to hedge forward production. It's the biggest
9 piece of our positions that we would put on the
10 marketplace as well as some of the, you know, time
11 spreads and location spreads, only the
12 transportation and storage. So everything we do
13 is, from the corporate perspective, is vetted and
14 really looked at to hedge anticipated future
15 production.

16 MR. COSGROVE: Just as a follow on to
17 that, has Anadarko noticed a change in the ability
18 to access markets for hedging, and if so, can you
19 kind of illustrate that to some degree?

20 MR. MCCOY: Well, I think besides the
21 regulations, the other thing that's impacted my
22 liquidity is just a lack of volatility, and some

1 of the banking participants in the market has
2 disappeared, there's no doubt. It is a little
3 more challenging to execute the hedges that we try
4 to put on, particularly as we go further out the
5 curve. I think we would like to have a little bit
6 more elongated hedges, but we typically now stay
7 within a 12- to 18-month time period as a result
8 of some liquidity and the bid spreads that we see
9 out there.

10 MR. COSGROVE: I'm just going to ask one
11 last question and then I'll let everybody else
12 have a shot here. In terms of the availability of
13 counterparties for hedging, do you see a trend at
14 this point or do you see that there's been some
15 kind of change, you know, that you've just
16 described and that you've reached sort of a
17 stasis? I mean, do you perceive that liquidity is
18 improving, holding the same, or decreasing?

19 MR. MCCOY: I think it's kind of leveled
20 out a little bit, so I don't think we see the same
21 degree of change we saw in the last two or three
22 years. But any additional burdensome requirements

1 or additional restrictions on limits we are
2 concerned that would further limit liquidity in
3 the marketplace.

4 MR. COSGROVE: Thank you. I saw Jim's
5 card go up first.

6 MR. ALLISON: Thank you. Question for
7 clarification for, I guess, anybody on the panel.
8 The term "phased-in approach" could mean a couple
9 of different things. One possible meaning would
10 be a proposal that is enacted as a final rule, but
11 it has different compliance dates for different
12 timeframes. I gather that is not what you mean.
13 I gather what you mean is a phased-in approach in
14 which a rule is passed that deals with one
15 particular phase, spot month. And then a separate
16 rule is passed to deal with other phases. Do I
17 understand you correctly?

18 MR. BOURGEOIS: Jim, that's an excellent
19 question. Because, for example, I mentioned a
20 number of other rulemakings with phased
21 approaches, as you point out, and in some of those
22 cases there is a final approach that has different

1 compliance dates. But FIA believes in this regard
2 that a phased approach should suggest that for the
3 non-spot month that there be a separate rulemaking
4 to enable market participants to provide comment
5 as the Commission gains experience in
6 implementation of an existing rule that would deal
7 with the spot month.

8 MR. BERGER: I would just add that MFA
9 concurs with that. In particular, believes that
10 the data that we'll gather in the improvements on
11 the data that we already have will occur during
12 the first phase would probably necessitate a
13 reproposal of the second phase anyway, so that's
14 why we would advocate for a separate rule-making
15 for the second phase.

16 MR. COSGROVE: Commissioner?

17 COMMISSIONER GIANCARLO: One of the
18 challenges that was identified in the first panel
19 this morning to an authorization of exchanges to
20 manage non-enumerated hedges is the area of
21 over-the-counter products. Could you see how,
22 perhaps, a phased rule-making approach might also

1 be suitable for dealing with that problem? That
2 we might be able to learn things from an
3 authorization for listed products before moving on
4 to, perhaps, over- the-counter products?

5 MR. MCCOY: I think anything we can do
6 to get additional data and to understand, you
7 know, what's behind the data would help us
8 establish limits that are reasonable and achieve
9 the objectives that the Commission is looking to
10 achieve here. So, yes, I do think that once we
11 get some better data we can expand it to also look
12 at the OTC area as well.

13 MR. BOURGEOIS: Just to elaborate on
14 that, I think that the data that will require the
15 greatest deal of attention is this question about
16 open interest and looking at the data of the OTC
17 swaps market in conjunction with the futures
18 market. I know that watching your presentations
19 you talked about the spot month and looking at
20 deliverable supply with respect to physically
21 settled contracts versus the financially settled
22 contracts where, perhaps, once you look at open

1 interest in the current proposal, one of the
2 greatest challenges, I think, FIA has recognized,
3 and others have recognized is, for the non-spot
4 month, relying on the open interest data of
5 futures without necessarily taking into account
6 the size of the OTC swap market.

7 MR. BERGER: I'd just add I think -- you
8 know, in Phase I you still have the existing
9 exchange, you know, position accountability levels
10 for the non-spot month, so Phase 2 is really
11 moving that towards, you know, both a federal as
12 opposed to exchange-level position accountability
13 limits in the non-spot month. But also then
14 bringing in the OTC portion into that in addition
15 to the exchange-traded portion.

16 MR. COSGROVE: Brian?

17 MR. DURKIN: Thank you. And thank you
18 for your presentation. It seems as though we're
19 seeing a lot of commonality in terms of possible
20 approaches to this issue of limits and a lot of
21 consistency in terms of support for a spot month
22 limit regime, and the accountability mechanisms

1 that are in place today seem to be getting a great
2 deal of support from the community, which we
3 believe is the appropriate path forward.

4 There were some comments that were made,
5 and happy to hear that they were made in the
6 context of why we're here, and ensuring the
7 consistent performance of these contracts. In
8 particular, having confidence in contract
9 convergence, which is very critical to why we have
10 a hard spot month limits regime in place today for
11 many of our contracts. However, you know, I would
12 have to emphasize the positioning and making sure
13 that you have that confidence in terms of contract
14 convergence. We would not be supportive of having
15 a difference of limits between physically settled
16 and financially settled products. We do have
17 concerns in the context of any changes in dynamics
18 there, not having a 1 for 1 parity in treatment
19 could actually have a very detrimental effect to
20 the overall performance of that physically settled
21 contract.

22 MR. COSGROVE: I believe Russ is next

1 and then Ben.

2 MR. WASSON: I'd like to ask the group,
3 who can tell me what the deliverable supply of
4 electricity is in the United States? Does anybody
5 know? Well, I'll tell you what it is. It's the
6 demand for electricity because electricity's a
7 constant delivery product, unlike any other
8 commodity that we're talking about here. As a
9 constant delivery product when you start talking
10 about things like spot month, and you start
11 talking about things like having to enumerate your
12 commercial hedges, which commercial end-users are
13 responding to changes in demand in real time.

14 I have to tell you, our members are
15 exceptionally compliance-oriented, but I don't
16 think they can comply with this. I don't think
17 any electric utility can actually comply with
18 this. So when we talk about commodities, every
19 other commodity that we're discussing, everything
20 you say is true. But I don't see how that's true
21 for the electric commodity because it's unlike any
22 other commodity that we're talking about.

1 MR. JACKSON: Thanks, Michael. Thanks
2 for the presentations. We agree with that
3 phased-in approach as it was clarified out how it
4 was defined. In simple terms, the reason is that
5 there's a heck of a lot of work we have to do to
6 even get it right in the spot month. Examples,
7 the presentations from this morning that were very
8 well done in collaboration between ICE and CME
9 which is novel in and of itself. Just to
10 implement that in the spot month and to think
11 about all that dynamic and process that needs to
12 get sorted out between the exchanges, the
13 Commission, and our market participants we have to
14 get that right. We have to get that right for our
15 market participants so that we don't slow down
16 their ability to execute hedges and reduce risk.

17 Second is the definition of enumerated
18 hedge. There's still a lot of work on what
19 qualifies as an enumerated hedge. There's been a
20 ton of comments on this from commercial market
21 participants that the Commission has received on
22 this, and we need to get this right. It's not

1 just an energy issue. It's an equal issue for
2 participants in my agricultural markets.

3 Third, it's been brought up a couple of
4 times in this panel, which I appreciate, is that
5 the deliverable supply definition, we need to get
6 that right for our customers. That needs to be
7 accurate and reflect the true amount of supply
8 that can reasonably be delivered at delivery
9 points. Y.J., you brought up the example of
10 natural gas in your presentation. I'd also
11 highlight a recent filing we've made around Zone G
12 in power. Based on comments we've gotten from
13 market participants that that deliverable supply
14 estimate for power needs to be updated to reflect
15 commercial reality for that point.

16 Fourth, I'd highlight, is just the pace
17 of overall change. The potential of all this
18 change getting implemented on our commercial
19 market participants has the potential to drain
20 liquidity from the exchanges to the bilateral OTC
21 markets which, I believe, runs counter to some of
22 the objectives of Dodd-Frank.

1 MS. PARIKH: I'd just like to go back
2 quickly to the Commissioner's question about OTC
3 contracts. I do agree with everything that's been
4 said today. I think that, especially for OTC
5 contracts, I mean, we don't agree that there needs
6 to be limits outside of the spot month, but if
7 there are, we think there should be a minimum at
8 least 12 to 18 months of data before the
9 Commission even considers that. Part of that goes
10 back to the regulatory burdens that I mentioned
11 earlier. Those burdens are increased for OTC
12 contracts since they're not standardized and they
13 have individual forms.

14 There's a lot of work that's going to be
15 needed under the proposed rule for end users just
16 to comply with the recordkeeping requirements, to
17 comply with the transactional requirements. Those
18 are compounded for OTC contracts going forward.
19 So there needs a lot of work to be done just to
20 get the current regime right before we can think
21 about expanding it to contracts where, as others
22 have mentioned, there's even less liquidity and

1 less need for it.

2 MR. COSGROVE: Professor?

3 MR. PIRRONG: Morning, I guess. No,
4 it's afternoon. It's a pleasure to be here. I
5 just want to make a couple of comments. In part,
6 responding to what Brian and Russ said. First of
7 all, I think that a phased in approach is a good
8 idea because there is an anti-manipulation
9 rationale for spot month limits that does not
10 exist for outer-month limits, and so I think that
11 should be the focus.

12 In terms of the implementation of spot
13 month limits, I agree with Brian that there's
14 really no rationale for distinguishing financially
15 settled from physically settled contracts. The
16 reason for that is, is how does one manipulate a
17 physically settled contract by demanding excessive
18 deliveries against that contract, creating
19 excessive demand in the cash market to drive up
20 prices that allow you to liquidate the rest of
21 your position at an artificially high price?
22 Well, if you have a big financially settled

1 position you can exercise that market power in the
2 physical cash market itself in order to elevate
3 prices and profit the rest of your position.

4 This is particularly true in the case of
5 electricity, going to Russ's point, which is that
6 the way you manipulate an electricity market is
7 withholding some physical asset like generation or
8 transmission. You can do that to advantage a
9 financially settled position. So I don't think
10 that there's any justification for a distinction
11 between these two. Actually, I wrote some
12 articles about this 15 years ago, about this
13 specific issue, so I think that this is something
14 that deserves some more attention.

15 In terms of the definition of
16 deliverable supply, one issue that's always struck
17 me is the potential inconsistency between the
18 definitions of deliverable supply for the purposes
19 of position limits and the way that the Commission
20 has treated deliverable supply in some
21 manipulation cases. So I think that that's
22 something that deserves some further thought in

1 order to make those things consistent.

2 MR. CAMPBELL: It is all about
3 liquidity. I really hope I don't live through
4 another financial crisis, but if I do it is going
5 to be the result of illiquidity in the market. I
6 can't set the regulatory agenda for the Commission
7 and financial regulators in general. But if I
8 were to set that agenda I would be focused on how
9 to prevent -- reduce liquidity in the market, how
10 to increase liquidity in the market. Because at
11 the end of the day, it is just paramount.

12 Paramount for our hedging on exchanges, our access
13 as a corporation to capital markets. We're
14 starting to see the trickle-down effects of
15 financial reform on liquidity in general. I'm
16 really fearful that that is going to cause the
17 next squeeze, and the next crash, and the next
18 crisis if something's not done to reverse that.

19 The focus on liquidity here is great. I
20 think that's right. I think if we do go with the
21 position limits regime we really need to see the
22 impacts of that regime on liquidity in the spot

1 month first before we start imposing limits on
2 outer months. Already in the electricity markets
3 we're seeing some markets that just aren't trading
4 really at all outside of the prompt year, even
5 some within the prompt year, outside of the prompt
6 three months. So we're already seeing the impact
7 of liquidity out the curve, certainly in the power
8 markets. Before we, sort of, put a position
9 limits regime on all months combined and spot
10 months I think we really need to study the impact
11 of position limits on liquidity in the spot month
12 before we move forward with all months combined.

13 MR. COSGROVE: Mike?

14 MR. PROKOP: Lael, your last statement
15 is exactly where I was going. I think what this
16 does now, and I'll summarize just a few of the
17 points that the panel brought forth very well. It
18 allows the Commission with a phased-in approach to
19 actually do a phased-in economic study on the
20 effects in the marketplace of these position
21 limits. In my history, in seeing how the
22 Commission performs, I know one of the most

1 difficult tasks that they're charged with is
2 actually coming forth with a bona fide, good
3 economic study of the impacts of these rules and
4 proposals.

5 Doing this, we basically have a faith
6 not only phased in implementation of the rules
7 themselves, but phases in economic study. So
8 pointing out, Y.J., you said right now your
9 numbers show there's a 5.7 BCF deliverable
10 capacity at the hub, roughly over 4,000 contracts
11 under current rules per participant. I know,
12 William, you pointed out the current FTC funding
13 issues that exist, and the CFTC's ability to look
14 at data, study data, get data, even. You also
15 pointed out the existing statutes, and also the
16 examples of past history where the CFTC has
17 actually used a phased-in approach.

18 Finally, Steven, you alluded to
19 something along these lines, I believe, in your
20 presentation as well. So to me it makes sense to
21 have a phased-in approach not only of the rules
22 themselves, but also to benefit the Commission

1 given the unfortunate past history we had with the
2 first position limit round that we had with the
3 vacating of the rule in the courts, I think it
4 behooves both the industry and the CFTC to look at
5 that just from the standpoint of having that
6 phased-in economic impact study. Thank you.

7 MR. COSGROVE: Jim?

8 MR. ALLISON: Two points. First one, I
9 am going to take the risk of disagreeing with
10 Professor Pirrong, at least ever so slightly. So
11 in the discussion of whether it is sensible to
12 have different sorts of position limits for
13 physical versus financially settled derivatives,
14 Professor Pirrong's arguments for having them the
15 same were largely based on manipulation arguments.
16 I would like to note that manipulation is illegal,
17 has been illegal for approximately forever, and
18 will remain illegal.

19 The role of position limits isn't to
20 make manipulation illegal. The role for position
21 limits is to reduce the threat of excessive
22 speculation. So if we assume we already have an

1 effective anti-manipulation regime in place, the
2 question then is given the effect of anti-
3 manipulation regime what is the propensity for
4 something to create the threat of excessive
5 speculation. I won't belabor it further, but I
6 think assuming the effective anti-manipulation
7 regime, I think the financially settled have a far
8 lower threat of excessive speculation problems
9 than the physically delivered.

10 Second, if I can follow up on a point
11 Lael made about liquidity. In response to a
12 different question, some of our folks had pulled
13 together some data that yesterday I had shared
14 with the Chairman and this morning with
15 Commissioner Giancarlo. I hadn't anticipated
16 using it at this meeting, but we had looked at
17 bid- ask spreads and market depth in the natural
18 gas financial basis markets out one year. When we
19 looked at that data we observed that the bid-ask
20 spreads across most of the delivery points had
21 widened a little bit, although bid ask spreads
22 were still quite tight. If there is a liquidity

1 problem, bid-ask is not where it was manifesting
2 itself.

3 They also looked at what they call depth
4 market, so the question you ask the trader is, on
5 a normal trading day how much volume could you
6 transact without moving the market? There have,
7 in fact, been substantial reductions in market
8 depth since three years ago. In the case of the
9 most liquid eastern points the traders were saying
10 that three years ago they could do five contracts
11 a day worth of business and not move the market.
12 That's down to one contract a day now. So that is
13 a sign of what I might call a fragile market.
14 You've got nice, tight bid ask spreads. You get
15 in to do one deal, but if you suddenly need to do
16 a lot of business there's not the market depth to
17 support that.

18 That is problematic for consumers
19 because in the current environment, low prices,
20 low volatility, the big consumers of gas have less
21 incentive to hedge. But if conditions change so
22 that now they suddenly want to put a lot of hedges

1 in place it is not obvious that there is the
2 market depth to support that. Of course, the way
3 the market will react is, we will see bid-ask
4 spreads widening dramatically, maybe prices
5 change, and eventually that will draw more
6 participants into the market. But as the market
7 stands right now, there is a sign of fragility in
8 the form of this dramatic reduction in market
9 depth.

10 I had not intended to use that at this
11 meeting, so I don't know what I need to do to get
12 the piece of paper I gave you onto the record, but
13 I'll defer to your judgement on that point.

14 COMMISSIONER GIANCARLO: I was going to
15 ask you that. Since you mentioned it, Jim, if you
16 could have something to go on the record of the
17 Committee meeting.

18 MR. ALLISON: I'll put it in, and, Mark,
19 I can give you a copy also.

20 MR. COSGROVE: Okay. Well, I would like
21 to thank our panelists for some very rich and
22 well-informed views. At this point we'll take a

1 break for lunch. We'll come back promptly at 2:15
2 and conclude with our third panel. Thank you.

3 COMMISSIONER GIANCARLO: Okay. We're
4 ready to begin. So for our final panel this
5 afternoon we are going to be discussing trade
6 options in forwards with embedded volumetric
7 optionality. Continuing on with our excellent
8 panels from earlier this morning, I will let this
9 panel introduce themselves and begin.

10 MR. HUGHES: All right. Let's have some
11 fun. Nothing more exciting than talking about a
12 little trade options this afternoon. There's
13 three of us here and we've just been talking.
14 Really, I think all of this hope that this is
15 going to be as much as a conversation as anything
16 else as we go, so I don't want to spend a whole
17 lot of time on our presentations. I really would
18 like to hear some feedback as we walk through
19 this. I think it's been nice this morning, it
20 felt a little bit like a workshop there for a
21 little while, and I think that's what we're
22 trying to do. As we go through this, I think

1 Michael will lead us through it, but bear with us.
2 We're going to throw up a couple of pictures along
3 the way. We may reference them back later on, but
4 we're just going to walk through this and let you
5 know what we're seeing and then what we're doing
6 as an industry and anybody can jump in.

7 MS. SHARMA-FRANK: Just a bit of mundane
8 before the fun. Our disclaimer above states that
9 materials and statements expressed in this
10 presentation do not necessarily reflect the views
11 of any particular company or association with
12 respect to any issue discussed herein, and are not
13 attributable to any party other than the
14 presenters. Just to reiterate with Paul said,
15 really the goal of our slides today is to settle
16 some scenarios that are representative of some of
17 the discussions that are going on. We do look to
18 the rest of the committee today to provide their
19 views and thoughts as we review our slides, so
20 just keep track of things you hear us say and in
21 our discussion portion we'll certainly open it up
22 for that.

1 MR. HUGHES: All right. Since we were
2 here last time, obviously, the proposed TO has
3 come out. I would say that generally supportive
4 (inaudible) we like it. Most of the folks we've
5 spoken with generally like what happened in the TO
6 rule, our proposed TO rule. Look, there's some
7 things we'd like to say, maybe tweaked or changed
8 a little bit, some modifications or some
9 clarifications along the way, maybe particularly
10 in the preamble guidance, but on a whole, it felt
11 like a very good move forward in the right
12 direction.

13 There are a couple of things, perhaps,
14 we were slightly disappointed on. It would be
15 with no mention of the position limits exemption
16 in the trade option rule. We would have liked to
17 have seen that, simply, One reason, because the
18 order seems to matter. If we can get that taken
19 off the table it might clear things up, and when
20 we talk about position limits and we comment on
21 position limits if trade options aren't a part of
22 the argument I think it makes things a little bit

1 clearer. There might be fewer commenters and we
2 even talked about it a little bit this morning.
3 It makes it easier to define the size of the OTC
4 markets.

5 We, Southern Company, are in the process
6 of reevaluating some of our contracts as we look
7 at the new EVO rules that came out in December as
8 well. But the clarity has also been very
9 positive, I think we have a little bit of a sign
10 of relief, some of the changes that were made to
11 the seven part test, in particular. However, I
12 think since then as we have sat in some of the
13 various trade association groups, whether it be
14 EEI or ICA or just conversations amongst
15 ourselves, we've had a fair amount of conversation
16 in the last several months since at least the TO
17 rule came out about the treatment of capacity
18 contracts in the electric markets, and the way we
19 look at contracts that allow for zero or nominal
20 delivery, so we'll talk about that a little bit
21 more as we go through this afternoon, and maybe
22 talk about is there some ways that we could, in

1 the TO rule, where, perhaps, the Commission might
2 be able to provide a little bit more clarity.

3 So with that said, we'll move forward a
4 slide, and if you will forgive me I'm an
5 accountant, risk manager talking about trade, not
6 an artist, but if you will look at that any maybe
7 you can kind of envision a bridge. This was
8 inspired by the comments from the Joint
9 Association. They filed some comments and they
10 talked about the bridge between forwards and
11 swaps. When you look at that you see on the far
12 left the brick and mortar. There's simply a good
13 old- fashion forward contract. It's going to be
14 physically settled. If you move over to that
15 first span we talk about forward contract with
16 embedded optionality still with the intent to be
17 physically settled.

18 When we start to get in the middle of
19 that bridge we label a standalone commodity trade
20 option. You may have a little bit more option at
21 the beginning of that, but it's still intended to
22 be physically settled. We believe that facts and

1 circumstances would provide a lot of support in
2 that determination. As we move it further to the
3 right we see commodity options, your traditional
4 commodity options, financially settled, obviously.
5 Then far right, just a straight up financial swap.

6 All we've done at the bottom, on the
7 left underneath the forward contracts, from the
8 Act we've taken what a swap does not include. On
9 the right-hand side we talk about what the
10 definition of a swap is. I'm not going to read it
11 to you. I think everybody's seen this multiple
12 times, certainly on this Committee, probably
13 people have spent a lot of times reading those
14 words over and over and over again. What I would
15 really like to put out there and make sure that we
16 as an industry, and you as the commission and the
17 staff, I've had this fear that we have
18 nomenclature issues for a long, long time. When
19 we say one word it means something to the
20 industry. We say that same word it may mean
21 something different to the staff.

22 I'm afraid that's created a lot of

1 confusion. Sometimes the only way you can clear
2 up that confusion is just let's talk about it, and
3 that's what we're hoping we can do today. If you
4 look at that bridge you'll see that there's the
5 letters A and B. I mentioned to somebody during
6 the break, if I'd known somebody was going to
7 mention the tomato/tomato example maybe I would
8 have made those tomatoes. Some of the comments,
9 and I think Commissioner Bowen recognized some of
10 our concerns in her comments at the end of the TO
11 rule. In the energy industry we have some
12 contracts that when you first look at them you may
13 say that looks like there's an option there, but
14 when you dig deeper you realize, oh wait a minute.
15 That is a contract that is used for physical
16 purposes, and the only way that contract can be
17 settled is, indeed, physically.

18 But what I've tried to do on this slide
19 is point out, perhaps, two different places that
20 someone can use their judgment in determining what
21 a contract is. If you see where the letter B is,
22 I believe this is where we, as an industry, are

1 drawing a delineation between a contract that has
2 an intent to be physically settled, and therefore,
3 we would run that through the seven part test, the
4 three part test, all of our embedded optionality
5 test. I think the test, the way they're written,
6 kind of support that. The way that we get there
7 is, you know, kind of a play on words is the
8 bridge of facts and circumstances. I know that
9 there is some guidance that goes back to the
10 mid-80s that talks about how we're supposed to
11 view certain options, but I would contend that
12 back at that point in time we did not have energy
13 markets under the same jurisdiction of the CFTC as
14 we do not. Certainly not physical contracts as we
15 do today.

16 In addition, because our energy markets
17 are so different than agriculture market,
18 particularly when it comes to things like storage.
19 We can't just build a silo a store a bunch of
20 electricity in it. Even in the natural gas market
21 space, storage is limited. Everything is very
22 regional, so I think the facts and circumstances

1 allow us to look at that point B as deciding what
2 is intended to be physically settled. I
3 acknowledge, as a market participant, it is up to
4 me to keep enough records that I need to, so if
5 anybody asks the question I can show them, yes,
6 when I did this transaction I intended to be
7 physically settled.

8 At the end of the trade option rule in
9 the comment section, there is some language there
10 that would lead you to believe that some may be
11 viewing the delineation point at point A. That's
12 what I'm hoping we can talk about. I'm going to
13 move to the next slide real quick, and I'm going
14 to walk through an example for us, for Southern,
15 I'll mention gas a little bit and then I'll let
16 the people with me on this panel talk a little bit
17 more in more detail. We may come back to that
18 slide we looked at a second ago.

19 Just as kind of refresher of where we
20 are, you know, Southern Company we have a lot of
21 capacity. We have a generation fleet.
22 Generation, to us, is capacity. Our generation

1 fleet is pictured up there with the bad drawings
2 of some little factory looking thing, but you'll
3 see those check marks on several of those. You'll
4 see some of those labeled with PPA, so we may have
5 a power purchase agreement. You could look at
6 that and maybe say that's your generation fleet or
7 your generation portfolio. So we look at all of
8 those and every day we run what we call a
9 multi-factored dispatch model. We take lots of
10 things into account to determine which plants or
11 which capacity we're going to call on.

12 Now, we view a PPA in this model the
13 same way we would view a plant that we built
14 ourselves. We pay capacity payments. There's
15 charges we make on that, and so depending on
16 what's going on, so, for example, if it's 98
17 degrees outside and I've got a plant that has to
18 be out of service, well, I'm not going to include
19 that in my mix for that day. I'm going to include
20 things like how efficient each plant is, how
21 available it is to run, fuel cost, some of those
22 plants may be coal, some of them may be natural

1 gas, some of them may be renewables, solar, wind.
2 There's a whole list of factors. So I'll
3 determine that every single day. We constantly
4 are running these dispatch models and that's how I
5 determine what I'm going to call on. It may mean
6 calling on a contract, but that's what I'm going
7 to use to determine how I'm going to get the
8 electricity to my customer base.

9 Fortunately, I think the revisions that
10 were made to that seven factor test were
11 beneficial for us because it made things a little
12 bit clearer when we go through this process I'm
13 describing in the pictures. So for power
14 specifically, we do have regional physical
15 markets. Electricity is unique. I know you all
16 are probably tired of hearing this, but we can't
17 stop saying it, electricity's real time. Our
18 business we are entering into we have to have
19 capacity and energy at the same time. We can't
20 have energy without any capacity, and if I had
21 with me a contract of a PPA it might be 100 pages,
22 might be 200 pages, it might be with somebody else

1 on this panel. Say it's a contract I entered into
2 four years' ago. When you evaluated that contract
3 you would see capacity payments. You could look
4 at the invoices. You'd see capacity charges for
5 \$X million and however many thousands of
6 megawatts. You would see energy charges on there
7 as well. That contract has produced power ever
8 single month that we've had it in effect.

9 However, those contracts also have to
10 retain the ability to take zero because we have to
11 protect the integrity of the grid. There are
12 times when there's more electricity produced than
13 there is demand. You can't threaten the grid
14 because of that. You also have the inverse. So
15 I'm getting to this idea that there's a time and
16 place, particularly in the electric markets and
17 the natural gas markets as well, where it is
18 perfectly acceptable, and I believe it makes
19 absolute sense that our contracts allow us to take
20 zero or a non-nominal amount, I think is the
21 phrase we've used.

22 One thing that I think is also

1 interesting is, we call these capacity contracts
2 because there's capacity and then there's also
3 electricity. The accounting rules, the SEC, FASB,
4 some of you have heard of the old FAS 133 market
5 market rules, right? I know we've got a few
6 accountants around here. This was put into place
7 with FAS 133. It's now called ASC 815. The FASB
8 is actually already kind of ground through a lot
9 of this sausage we've talked about over the last
10 couple of years in that they recognize that there
11 are contracts that when you look at those
12 initially look like derivatives, but when you get
13 into the meat of them that they're really not.
14 They're intended for physically settlement, and
15 FASB and the SEC they have something they call a
16 normal purchase, normal sale. They designate some
17 electricity contracts, it's a fairly high
18 standard, but they designate some of those as
19 normal purchase, normal sales, so they're not
20 included as derivatives.

21 I have this fear, and it's reflected in
22 our comments, that if we're not careful we could

1 end up with a situation where I have a swap, as
2 defined by the CFTC, that is not a derivative per
3 my accounting records. That is not where I don't
4 think anybody want to really end up. The way that
5 I feel like we can kind of bridge that gap using
6 the bridge analysis is there is a facts and
7 circumstances element that our industry is
8 utilizing and using. I think we're relying on
9 that because we can demonstrate that even though
10 we may allow for a zero non-nominal delivery we
11 can demonstrate that these contracts are being
12 used every day to keep the lights on or a day like
13 today or a summer like this summer to keep the air
14 conditioning on, right? We have to do that.

15 The gas markets, and they're going to
16 talk about this a lot more, are very similar.
17 They're regional in nature. They're storage is
18 not unlimited. It kind of depends on where you
19 are. Their real time nature of their business,
20 partially to support our business, also requires
21 the ability to take zero, but it does not ever
22 change the intent to physically settle. In those

1 instances as well, I think we're talking about a
2 facts and circumstances analysis that should allow
3 us to take our contracts, which we're going to
4 view as physical contracts, and run those through
5 the tests that we've come up with the last few
6 years. Because we do not want to end up with a
7 situation where we cannot utilize those test that
8 we all worked so hard on. I think I'm going to
9 turn it over to Arushi and she's going to walk
10 through some more.

11 MS. SHARMA-FRANK: Thank you, Paul.
12 Just to reiterate some of the things we've just
13 gone over, and we've talked a little bit about the
14 swap definition and about the interpretations.
15 We've talked about the basics of facts and
16 circumstances, and we've talked about also
17 capacity contracts. So we're kind of laying out
18 for your now, sort of, a framework for informing
19 our discussion as a group. How does a facts and
20 circumstances apply now in light of the
21 interpretation and the proposed TO guidance, TO
22 rule?

1 In addition to that, what's happening in
2 the market now that could be addressed in the
3 final TO rule, and, perhaps, what other actions
4 items might be on the list for the Commission to
5 consider in conjunction with that. Separately, we
6 can talk a little bit more about the exclusion of
7 position limits, applicability trade options.

8 I've got a slightly more details example
9 up on this screen discussing how the facts and
10 circumstances analysis might be applied in the
11 physical gas contracting space. Taking as a basis
12 for that model the very standard daily call,
13 Platts gas daily peaking supply contract, called
14 sometimes a swing. But the underlying point is
15 that a secured firm right to call on natural gas.
16 I want to go into a little detail on how you get
17 to that type of contract because the devil is on
18 those details. How we apply the facts and
19 circumstances test is not simply a look at what a
20 confirm or what a specific deal says with respect
21 to whether you're going to take 0, 10,000 or some
22 percentage thereof. There's a lot more there.

1 I think one of the places we might be
2 talked past each other in the energy industry and
3 with a commission, at least in some of the
4 deliberations we've had through the common docket
5 is a more full understanding of what it is that's
6 happening pursuant to an agreement for a peaking
7 supply where you make take a zero or a nominal
8 volume.

9 Where we started out on the slide here
10 is that we're discussing a deal between a natural
11 gas utility, a local distribution company entering
12 into a master physical gas or a base supply
13 agreement. There are many terms for that
14 agreement when using a generic form here with a
15 gas producer that has the independent ability to
16 procure or has their own gas storage. I put the
17 date 1998 there to make a very important point
18 which is that there is a physical course of
19 dealing that exists between a utility and its
20 physical gas counterparties which can date back
21 years or even decades. That course of dealing is
22 reflected in a base contract, and a base contract

1 is not, I repeat it, it's not the transaction's
2 price and quantity terms. It is, literally,
3 everything else, but for that. Up to and
4 including things like liquid damages if one party
5 doesn't perform. Again, liquidated damages in the
6 context of physical settlement. So if you were to
7 not bring the gas to the receipt point then you
8 would pay a fee so that the utility could go out
9 and buy that physical commodity somewhere else.

10 Where the receipt points would be on the
11 system, which will be further informed by the
12 transaction confirmation, and most importantly,
13 the master agreement itself which is the physical
14 supply, sale and purchase agreement does not
15 create any obligation on either party to do
16 anything which means enter into any specific deal
17 for physical gas which is where you get the
18 construct then for what happens in a transaction
19 confirmation. So the master gas agreement sets up
20 that very general course of dealing and defines
21 the non-price, non-quantity terms of the overall
22 agreement.

1 Then you move forward in time, and I've
2 used a date here, I think I've got a date up
3 there, but this could be any time. This could be
4 ten years' later, five years' later, two years'
5 later. The gas utility is planning for its winter
6 procurement. It's doing that the May before the
7 upcoming winter in a heating season. The utility
8 will go out, and depending on what the utility
9 needs, again, referencing what Paul called sort of
10 a tool box or a stack of the different types of
11 procurement options that the company may have to
12 fulfill its physical needs. The utility will go
13 out through either a formalized RFP process or
14 independent phone calls or emails or publishing a
15 notice to the counterparties with which it has a
16 master agreement in place, and puts out the
17 request for proposals for satisfying certain
18 requirements that the gas utility may need.

19 The purpose of doing that solicitation
20 is to have it all in place, not necessarily to
21 confirm delivery at that point or confirm delivery
22 in the future. The different types of deals,

1 again, I made some generic terms up there.
2 Contracts are B1, B2, B3. These are all
3 requirements and you can basically check box as a
4 counterparty and then you get to the point where
5 you itemize your price in quantity terms and
6 memorialize those in a transaction confirmation.
7 That's where, in this example, zero to 10,000 or
8 500 to 10,000 or a minimum take of 6,000, that's
9 where those additional terms materialize, in the
10 confirmations.

11 So you can see there are three scenarios
12 up there. One is interruptible delivery. That's
13 fully interruptible by the buyer or seller. It's
14 not necessarily even viewed as a forward
15 obligation in the sense that neither the buyer or
16 seller have to do anything. The second is a firm
17 variable agreement which will involve some sort of
18 base or minimum take, and some swing component
19 which may be a percentage of the base amount or it
20 may be an additional swing amount that's designed
21 to serve a exigent need like the weather becoming
22 colder than expected.

1 The third contract is a pure firm call
2 right, just a firm contract. It has no specific
3 baseload or minimum take component, but it has a
4 swing component, and that's where you have the
5 zero to 10,000 type example. Where you have a
6 peaking or a swing of an up to a fixed quantity.
7 That's reflected on the agreement. Just a
8 reminder that each of these confirmations could be
9 executed with any of the counter parties with
10 which the utility has a basic supply agreement.

11 Then the food for thought for us to
12 think about then is the very last portion of the
13 slide. Given what we know about this overall
14 agreement how would you classify these contracts?
15 We'll just think about that for a minute as we go
16 into a little more on how the market is responding
17 to the CFTC rules.

18 This slide is a very summary take, but
19 I'll go into just a little bit detail on regarding
20 where we are now, where we were following the
21 interpretation's release, the final embedded
22 volumetric optionality interpretation, and where

1 we could be moving forward. The first bullet
2 discusses how clarity has been achieved on firm,
3 variable, and interruptible. Those were the first
4 two types of deal confirmations I discussed on the
5 previous slide. And the important point here that
6 the interpretation really helped with was this
7 notion of a minimum take requirement.

8 Before we had the interpretation, there
9 was still some uncertainty in the market that if a
10 contract required you to take a certain amount, a
11 percentage take of that amount, if that was the
12 actual amount delivered under that contract that
13 may be inconsistent with the prior seven factor
14 test. That clarity has been achieved for a lot of
15 market participants. I think that that's where I
16 think Paul and I might both agree that we really
17 feel like we're in a better place with the
18 interpretation.

19 But then we're not really here to talk
20 about just where the clarity is, but where it's
21 not. That's in the last contractual example that
22 I put up there on the previous slide which is the

1 treatment of firm by market participants. That,
2 to this day, is inconsistent. There's a few
3 reasons for that and I just want to go through a
4 couple examples of what those are.

5 First of all, this notion of zero
6 delivery. As Paul was saying on his former slide
7 regarding the bridge there were two inflection
8 points where the analysis starts and stops whether
9 we're talking about a forward, a physically
10 settled option, or a trade option. Minding the
11 fact that a trade option or any option is treated
12 in the CFTC regulatory landscape as a swap. So
13 right now we still have concerns in the
14 marketplace about how you would characterize those
15 contracts. I loved Paul usage of the word
16 nomenclature. Nomenclature has really been the
17 issue. The agree to disagree clause has been
18 rampant in how gas counterparties have modified
19 their physical contracting relationship.

20 One counterparty, which is more
21 sophisticated potentially, and is already doing a
22 lot of work to report other trade options or other

1 swaps may decide that that agreement is a trade
2 option and report it as such. The other
3 counterparty, even though that counterparty is
4 filing Form TO since TO, for example, is a form
5 that needs to be filed by both parties if it's an
6 end user to end user deal. Then the parties might
7 agree to disagree on what the transaction is
8 classified as. We've got a lot of examples in
9 terms of form agreements that have been pervasive
10 in the marketplace.

11 IECA is a good example. The IECA did a
12 form letter representation quite a few years ago
13 that would memorialize that people may disagree
14 ultimately as to how they classify that contract
15 for their reporting purposes, how they classify it
16 internally to their company.

17 Another thing that we're seeing right
18 now is that smaller suppliers, independent
19 producers, marketers, storage providers, again,
20 emphasizing this notion that these are smaller end
21 users, often enter into these deals with other end
22 users which may be larger, but nevertheless, may

1 not have a single other CFTC Part 45 reporting
2 requirement. These smaller suppliers are still
3 not responding to solicitations or RFPs that are
4 very similar to or identical to the types that I
5 discussed on the earlier example slide.

6 I've gotten the question that well,
7 what's the problem now? The TO reporting
8 requirement may disappear altogether. What is it?
9 Why would these market participants not come back?
10 I have a few points about that that I'd like to
11 share. One is, definitely, that there's still
12 uncertainty about the zero deliver contract. The
13 smaller market participants really because they
14 don't interface with Dodd-Frank in any other way
15 would not want to invest the time, resources,
16 legal fees, and some of the other requirements to
17 figure out why it is that they might be regulated
18 by Dodd-Frank. So the specter of dealing with
19 Dodd-Frank for a purely physical, small producer,
20 independent counterparty that does not have to
21 deal with any of these requirements in any other
22 context because they have a 100% physical business

1 is a sufficient incentive for them to not respond
2 to that type of RFP.

3 What happens if you do enter into an
4 agreement and one of your parties want the other
5 party, another end user wants to report that
6 transaction as a trade option because of this
7 uncertainty? Well, then you, as the other
8 counterparty, also need to report that transaction
9 as a TO. You need to obtain an LEI. You need to
10 engage in, if the trade option proposal were
11 finalized as written, you'd still need to engage
12 in some amount of due diligence and record
13 keeping, tracking and monitoring if you're going
14 to be entering into any volume that the other side
15 may end up reporting under the proposed 1 billion
16 requirement. You need to enter into reps, you
17 would need to modify your basic transaction
18 confirmations. Again, these are the actual deals,
19 B1 through B3 in my example, not the master gas
20 agreement, but the actual deals, to make sure that
21 you're consistent with the underlying terms of
22 what the interpretation or some amalgam of the

1 interpretation as well as a prior products'
2 release, and potentially what might be said in the
3 trade option rule.

4 I have to impress upon you also that
5 reps in the industry look completely different.
6 To the extent that transaction confirmations have
7 been modified in the gas space is just so that
8 counterparties can make sure that these are
9 treated as and viewed as physical deals. Those
10 reps can take the form of specifying one, two, or
11 three of the seven factors. They can take the
12 form of taking a little more of that or a legal
13 interpretation thereof that references back to
14 these releases from the Commission. Some
15 counterparties have a problem signing onto reps
16 for physical delivery agreements that don't all
17 look the same, so the amount of negotiation that
18 can go on to get the same physical firm call deals
19 done has really been immense for some companies.
20 That's a burden in and of itself.

21 So those are some of the basic issues
22 that we're still facing, and where we'd like to

1 see a little more clarity. I know that one of my
2 co-panelists, Amy, will be talking in a little
3 more detail about a standby peaking contract where
4 you can get a little more insight into the details
5 about this uncertainty.

6 Moving on, our slide, of course, is not
7 just to tell you today about the problems, but
8 also about solutions. We are, of course, very
9 grateful and respectful of the fact that the
10 Commission is looking at this issue. A lot of
11 work has already been done on this issue and we're
12 here to suggest things that the regulator can
13 adopt to help us get to a better place, and also
14 to ensure that we're not in the place where we're
15 talking past each other when, in fact, we may all
16 intend the same thing which is, essentially,
17 physically settled contracts and those that are
18 intended to be physically settled should not be in
19 the swaps world.

20 So for us, the TO proposal was an
21 important starting point. I do believe, based on
22 what I've heard from the smaller end users both in

1 the gas and the power space, especially in the
2 marketing space, is that they could get back in
3 the game if form TO is no longer required. So we
4 are very supportive of the elimination of form TO.
5 I also think that it's been pretty well settled in
6 the common docket that there are some concerns
7 about the alternative 1 billion notion of
8 reporting requirement. That pertains to, of
9 course, whether or not you'd have to be tracking
10 if you fall somewhere in the middle of that. I'll
11 let the Commission consider those comments in the
12 docket on that issue.

13 Some of the other comments raised a very
14 important point because they discuss the
15 quantification challenges to valuation of TOs for
16 the purposes of satisfying (inaudible) which is
17 proposed 1 billion requirement. There are some
18 methodology proposals in the TO proposal that talk
19 about calculating future price quantity and what
20 it really envisions is that there is some sort of
21 cap on how much gas or electrons, as it may be,
22 how much of a commodity's actually taken and what

1 date and what price is listed for that commodity
2 at the time of physical settlement.

3 The challenges of quantification really
4 germinate from the fact that in the marketplace
5 there's an attempt to fit in TOs that are
6 physically settled and financially settled. With
7 that challenge before you, the question is what is
8 the appropriate way to report or track and value
9 for reporting purposes an open-ended physically
10 settled trade option. That issue has also been
11 discussed in these comments, and in the prior TO
12 common docket as well. It's, of course, one of
13 the issues alleged to other no action letters that
14 the divisions have issued in the past regarding
15 how evaluation should occur. It's the same story
16 again. It's the square peg in the round whole
17 which begs the question that why are physically
18 settled transactions being reported as trade
19 option in the first place when they bear no other
20 characteristics that intend any alternative
21 financial settlement?

22 Kind of to that point as well, something

1 I missed on a previous slide is that to the extent
2 in that example slide I shared there are financial
3 obligations built in or financial terms built in
4 to a master gas agreement or a base contract.
5 Those puts and calls are pursuant to additional
6 amendments to the master agreement or they're
7 actual phrases or language that is embedded in the
8 confirmation agreements. The market does a good
9 job of putting out very clearly in documentation
10 what type of deal you've got. You don't have a
11 situation where, in the gas world you would, for
12 example, have a peaking deal and also have some
13 type of severability of that deal that's not
14 enumerated very specifically in a confirmation or
15 in a master agreement. That, again, goes back to
16 the TO proposals. What are we talking about here?
17 How would I value a 0 to 10,000 deal under which I
18 don't have to take anything. I may not need to
19 take it until next year when gas daily is showing
20 a winter price that is 17 times the amount that it
21 is right now in May. How do I value that? So
22 that's another question that comes out in the TO

1 reporting context and has also been addressed in
2 comments.

3 So with the TO proposal being an
4 important starting point for us I think that we
5 are in a place where we need to talk about what
6 can be done in the final rule in addition to what
7 is already in the proposal that will really help.
8 We've got a few different points up on the screen.
9 Bearing in mind that the formulation up there is
10 something that is reflective in other comments
11 with slight tweaks. It goes all generally to that
12 point that the final rule should clarify and
13 affirm that physical contracts which allow for
14 zero or nominal delivery may satisfy the CFTC's
15 interpretation and guidance on forward contracts
16 and would not be regulated as trade options in
17 light of a facts and circumstances analysis
18 demonstrating that such contracts exclusively
19 intend physical settlement.

20 That statement, which Paul and I worked
21 on as a proposal, is replicated quite neatly in a
22 footnote to the actual EVO interpretation as well.

1 A language of that states, and this is looking at
2 Note 32 of the final interpretation. That's Page
3 10 if any of you have the release. Depending on
4 the relative facts and circumstances, capacity
5 contracts, peaking supply contracts, transmission
6 or transportation service agreements, and tolling
7 agreements may qualify as forward contracts with
8 embedded volumetric optionality provided they meet
9 elements of the CFTC's final interpretation.

10 In addition to that, and the
11 interpretation itself got several points noting
12 that this is a facts and circumstance analysis
13 consistent with the CFTC's prior precedent from
14 the 80s. As well as with what is contained and
15 preserved in the products' release. So we're
16 looking at a number of different documents. What
17 we'd like to do is be able to do exactly that, to
18 undertake the responsibility of engaging in a
19 compliance regime where we can use a facts and
20 circumstances analysis and apply it broadly across
21 the world of physical contracting. Whether it's
22 peaking supply, capacity or any others when the

1 exclusive intent of those contracts is physical
2 settlement.

3 Right underneath that I've got a point
4 discussing that our views are consistent with a
5 seven part test. The test itself effectively
6 contemplates that actual delivery may or may not
7 occur. The CFTC has already clarified and the
8 interpretation has been released that the
9 determining factor for whether or not you're
10 within the forward exclusion is the intent to
11 physically settle. So if the question is of
12 intent, and we struck language from the prior
13 seven factor test that gave the impression that
14 it's how you execute those obligations, and
15 whether or not there was execution. If intent is
16 the operative factor than that's consistent with
17 that fact that actual delivery may or may not
18 occur.

19 That, not standing along, but in light
20 of the other types of facts and circumstances that
21 may exist, for example, the existence of a master
22 gas agreement with your counterparty that only an

1 exclusively conned and placed physical settlement
2 that should be enough. Getting to that point can
3 be tough on your own as a company because you have
4 a culture of compliance that is very, very much
5 interested in making sure you're following the
6 rules. To get that clarify from the regulator
7 would be everyone's preference. We'd like to see
8 that type of uncertainty diminish as much as
9 possible. We know that the Commission has been
10 looking at this issue for years, and we think that
11 the TO final rule preamble language, for example,
12 is a good example.

13 The second bullet there is really
14 reiteration of what I just said, that capacity
15 contracts are another area where we really need
16 clarification. Paul made a great point earlier
17 when he was discussing what the exact issue was
18 with capacity contracts. That was that those
19 contracts produce every month, but you do have to
20 retain the ability to take zero because we need to
21 protect the integrity of the grid. There is a
22 place and time for using peaking supply, capacity,

1 and other physically settled contracts. They're
2 made as such whether or not there is a minimum
3 take obligation. That is something that we
4 recognize very broadly in the energy industry.
5 There's certainly a way forward for us to use the
6 illuminous guidance from the Commission today to
7 get there, but it looks like we might need
8 something else.

9 Finally, the final point is, of course,
10 that we really do want to see that TOs are
11 excluded from position limits in this final rule.
12 I must impress upon the point that one of the
13 other reasons that you might not have some
14 physical market participants entering into firm
15 call agreements with any of the suppliers of the
16 physical commodity in the marketplace, whether
17 you're talking about retail or wholesale, is
18 because it's a specter that future position
19 limits' rules may be applicable to those trade
20 options.

21 Just adding, again, this whole
22 evaluation issue and the simple idea of tracking

1 an exclusively physically settled trade option,
2 with quotes, is replicated and mirrored and
3 certainly exponentially a larger problem is you
4 were to try to track trade options for the
5 purposes of position limits' compliance. Paul,
6 are there other points you'd like to add?

7 MR. HUGHES: No.

8 MS. SHARMA-FRANK: Okay. So we did have
9 one last slide and that's something that's also
10 food for thought for you up there. We've gotten a
11 lot of questions about how the uncertainty around
12 this issue is impacting liquidity in a physical
13 marketplace. Aside from what I've told you
14 anecdotally I think the important point to
15 remember is that we're looking at a statute that
16 is about five years' old. By comparison, we're
17 able to look at what's happening in the physical
18 marketplace with gas and power in the traditional
19 energy space under statutes that are bordering on
20 80 years' old, at this point.

21 So to answer the liquidity question and
22 the longer term impact question, there is a need

1 to make sure that we're thinking about the
2 timeframe over which we would view those impacts.
3 I think it would be short-sighted of us to table
4 the issue of liquidity, but also it's important to
5 be aware that we're dealing with a new statute,
6 new rules, and new guidance that's just going to
7 start to be applied now, this year. I think that
8 where the Commission can go in a very positive
9 direction both for the Agency in terms of
10 addressing the issues that need to be addressed,
11 and for the marketplace is to really just hit this
12 issue very directly in the final TO rule.
13 Hopefully some of the discussion today we hear
14 from others can be a shared perspective on how
15 that might happen.

16 MS. FISHER: Hi. I'm Amy Fisher. I'm
17 the energy regulatory affairs leader at GE Energy
18 Financial Services. GEEFS is the asset manager of
19 a limited partnership which owns the Linden
20 Cogeneration Facility, and EFS owns 50% of that
21 facility. I'm here today to talk about one of the
22 ways in which Linden Cogen is able to arrange to

1 receive uninterrupted natural gas, its fuel for
2 generating electricity for sale to New York City,
3 and to produce steam for sale to the refinery that
4 it's co-located with.

5 Linden Cogen is shown in the photo.
6 It's located off of I-95 in Linden, New Jersey,
7 and I'm sure many of you have passed it and seen
8 its banner on the highway that says that it's
9 energy efficient and environmentally advanced. It
10 is co-located with the Phillips 66 Bayway Refinery
11 which is the largest refinery in the Northeast, so
12 20% of the gas in the entire East Coast comes from
13 that refinery.

14 Linden Cogen is a modern cogeneration
15 facility which uses natural gas efficiently. It
16 first produced electricity which is transmitted
17 over an underwater cable between New Jersey and a
18 con-ed substation on Staten Island, New York City.
19 The heat from the electricity production is then
20 used to produce a steady source of steam which is
21 critical for the Bayway refinery process use.
22 Linden Cogen was completed in 1992 as a project

1 financed entity which is a particular type of
2 financing structure which allows it to obtain data
3 at a lower cost because it is more highly rated
4 than its equity ownership. It was originally
5 owned by its developers which was a small company.

6 That project financing is a wonderful
7 financial technique which kind of creates a black
8 box where are the contractual relations that the
9 plant is going to have for the next 20 years are
10 determined up front, and many power plants are
11 financed in precisely this way, but the downside
12 of it is there is limited flexibility after that
13 for, you know, unintended changes in costs or
14 expenses that the plant might incur.

15 Linden uses natural gas as its fuel, and
16 it's the most critical component of its products.
17 The map shows a simplified path for fuel delivery,
18 so essentially the plant goes to the Gulf and
19 sources natural gas. It purchases the gas in the
20 Gulf and arranges to have it transported to a gas
21 hub where it is picked up by our local
22 distribution company which is called an LDC, and

1 that's essentially what is referred to as its city
2 gate. The LDC is a very highly regulated entity
3 by state regulators. It's a public utility. It
4 takes the gas that it buys from Linden at its city
5 gate and transports it to the burner tip to the
6 actual point at the facility where it's used.

7 The green dot on the slide is the Linden
8 Cogen plant. The blue dot is the con-ed
9 electrical substation in Staten Island. The
10 purple line is the underwater cable connecting the
11 two which transmits the electricity to New York
12 City.

13 So local distribution companies nearby
14 Linden Cogen are, as I said, utilities regulated
15 by the New Jersey Board of Public Utilities. The
16 LDCs have a service obligation for all customers
17 in the region and they operate under complex
18 tariffs which describe different types of service
19 that they provide to different classes of
20 customers. The rates and terms of service charged
21 by the LDCs need prior approval from the New
22 Jersey BPU. So Linden has an agreement with those

1 entities and that agreement, which is collectively
2 a full supply agreement of 100% of its fuel needs
3 was approved by the New Jersey BPU.

4 However, having said that, the LDCs are
5 required by the terms of their tariffs, again,
6 approved by the New Jersey BPU, to provide a
7 priority for residential heating purposes. So
8 these LDCs which provide natural gas to a large
9 industrial complex like Linden also are
10 responsible for literally providing residents in
11 Northern New Jersey with their heating needs.
12 Because of that, the New Jersey BPU requires that
13 industrial enterprise which, obviously, could
14 swamp each individual houses' heating needs that
15 there be a second back up supply for natural gas
16 for the industrial uses as such times when it is
17 cold out, below 22 degrees Fahrenheit, and at that
18 time there be another source of natural gas.

19 However, it is not clear that at the
20 time that those weather conditions exist that the
21 LDCs will not have enough gas to satisfy
22 everyone's uses. The BPU has another goal which

1 is to provide as much revenue to the LDCs as
2 possible, so that they can function appropriately.
3 They're not anxious to have the industrial loads
4 find some third- party source of natural gas. The
5 compromise is that Linden Cogen has to go out and
6 find some kind of contract which will allow them
7 to access that natural gas when told to do so by
8 the LDCs because they, themselves, cannot provide
9 natural gas on particular dates.

10 The way this works is that LDCs call up
11 Linden a day in advance and Linden calls a
12 supplier with whom it has a contract, and tells
13 them to go ahead and supply the natural gas. The
14 natural gas goes on the same path that I had
15 mentioned before, up from the Gulf, to the hub,
16 and then title is transferred to the LDCs at the
17 hub, and it's transported to the facility. None
18 of that happens unless the LDC calls up Linden the
19 day before and says, go activate and nominate the
20 gas under your standby peaking supply contract.

21 I just wanted to make this point because
22 I think it's quite important. It's very critical

1 for Linden to have 100% of its natural gas needed
2 satisfied one way or the other. We have a firm
3 contract to supply electricity in New York City.
4 We're 8% of the load serving capacity in New York
5 City. We also have a very firm contract with the
6 refinery to supply steam. We can't produce steam
7 unless we're running, and we can't run without
8 natural gas, and so you would think we have two
9 LDCs, one supplies 80% of our needs, the other
10 supplies 20% of our needs, but because both of
11 them can curtail us on cold days we need to
12 actually have another alternative. The other
13 alternative does not mean we're getting 100% of
14 our gas supply taken care of. We're still at
15 100%, but we need to have a plan B on those cold
16 days.

17 Just to talk about the terms of the
18 natural gas supply agreement. They need to be
19 approved of by the New Jersey regulators. They
20 only approve them on an annual basis. We go out
21 on an RFP basis. We get a third-party to commit
22 standby supply. The charge for that is a

1 reservation fee to standby. The gas is priced
2 upon delivery at the market price. In the event
3 that we're called on to nominate gas under these
4 contracts the utilities have, by definition,
5 agreed to purchase the gas from us when it gets to
6 their hub, so there's no ability to us to
7 speculate with this gas supply.

8 I guess I would say in just having heard
9 Paul and Arushi comment on this that I'm not even
10 sure we're even on the bridge, but assuming that
11 we are and we're looking at a forward contract
12 here and not just some commercial supply agreement
13 entirely outside the scope of CFTC rubric, why do
14 we need relief under the trade option rule?
15 Everyone beginning in 2012 took a very, very close
16 look at the nature of their contract relations and
17 specifically whether they were going to have
18 additional reporting requirements under contracts
19 like Linden's peaking gas contract.

20 I think when we went out and showed our
21 outside counsel who handles all of our Dodd-Frank
22 reporting requirements, when we showed them these

1 types of contracts they said, well, it's a
2 commodity and it's an option, even though it's not
3 your option, and so it must be a commodity option
4 subject to swap rules. We'll give you a break and
5 we'll call it a trade option, not some other sort
6 of swap. Therefore, all you need to do is file
7 this form and follow some of the reporting
8 requirements and you'll be set. That created
9 several issues for us.

10 The first was just a sense that our
11 people who run the Linden plant would not
12 necessarily realize that this would be considered
13 a trade option because they don't have any
14 optionality with the contract, so there's a
15 concern that we have that we might miss some
16 requirement even though those requirements might
17 be nominal. As Paul suggested, there is a
18 significant accounting issue. The normal purchase,
19 normal sale type of accounting that we would apply
20 to a peaking gas contract was put in question when
21 we started looking at these agreements as though
22 they might be trade options, and that cause all

1 kind of consternation until we worked through it.

2 In addition, the requirement that we
3 somehow track these separate from our other
4 commercial arrangements is very problematic.
5 Arushi mentioned the valuation issue. I would say
6 that the release as proposed suggests that there
7 ought to be some sort of mark to market because we
8 are pricing this thing as we use it rather than
9 having a fixed price. That is a big burden for us
10 for some of the reasons that have been suggested.
11 We would go back and challenge our counsel to
12 maybe come to another conclusion, but because of
13 the record around this issue at the Commission
14 it's very difficult to find a counsel that is not
15 going to immediately say, look, this is a nuanced
16 issue. We're not really sure how we should come
17 out, so we really think you should adopt a
18 conservative course and report this as a trade
19 option. That's precisely what we've been doing,
20 particularly as the panelists have suggested, our
21 counterparties have been reporting these as trade
22 options.

1 In light of what I've been suggesting we
2 would suggest that these contracts, in particular,
3 be taken out of the trade option category. We
4 realize through the rule the reporting
5 requirements have been reduced, and we very much
6 appreciate that, but we really think that it is
7 just not accurate to think about these types of
8 arrangements as options at all. It would be
9 helpful for us to have that acknowledged. We
10 think this issue has been outstanding for us since
11 2012, and has really caused a great deal of
12 thinking and a great deal of confusion in our
13 organization. We think that the trade option rule
14 is where people will look for guidance on this
15 point, and so we think it would be great to make
16 the clarification in the rule itself.

17 We very much appreciate Commission
18 Bowen's proposal, but we think that unless there's
19 some kind of clarification in this rule people who
20 are not as sophisticated as the people in this
21 room will say well, the Commission had an
22 opportunity to clarify this, Commissioner Bowen

1 identified the issue. They chose not to, so
2 therefore, they must consider these items to
3 continue to be trade options.

4 I wanted to just spend one more minute
5 telling you why this is important to not just
6 Linden Cogen, but to the industry as a whole. In
7 several of the regions where there are independent
8 system operators who balance the grid on a
9 regional basis, so, you know, that's New England,
10 specifically, and PJM, the Mid-Atlantic states.
11 There have been new rules just very recently put
12 into place which very dramatically penalize
13 entities that don't deliver power, generators that
14 don't deliver power when they're supposed to and
15 Although in the past there's been some belief that
16 not having natural gas would be a reason, an
17 excuse, to get out of those penalties it is quite
18 clear now that that is not the case.

19 Not dissimilarly to what Paul mentioned,
20 there is a dispatch stack and you're never quite
21 sure when you're going to be called, when you're
22 not going to be called as a generator. It is

1 difficult to commit to firm natural gas resource,
2 all the time, 24/7. So there's really going to be
3 a need to get firmable contracts not unlike
4 standby peaking gas contracts in order for
5 generators across the region to meet their
6 reliability requirements that are now imposed upon
7 them. I would suggest that if the Commission does
8 not take this up now it really will have to take
9 it up again at a reasonably soon basis.

10 Thank you very much for listening to
11 this story. I hope it's provided some clarity of
12 how something rather abstract can affect small
13 businesses and small end users. Thanks.

14 MR. COSGROVE: I saw Russ had his card
15 up first and then Jim.

16 MR. WASSON: Thank you. Our concern
17 with the question of trade options being deemed to
18 be swaps, which arose in the product
19 interpretation from 2012, without regard to the
20 statutory construction issue, is that if a trade
21 option is a swap, and as I told you at our last
22 meeting, with respect to our members, there's only

1 two possible outcomes with a trade option. Either
2 physical settlement or no transaction happens at
3 all. In light of that, if something's a swap we
4 have all this collateral damage that happens
5 across multiple CFTC rule makings.

6 For example, it throws us in to record
7 keeping and reporting for swaps and the deep end
8 of the pool with swap dealers and major swap
9 participants. We're a tiny, little physical end
10 users, but now we find ourselves subject to
11 reporting and record keeping requirements, the
12 same rules that apply to the largest and most
13 sophisticated financial institutions on the
14 planet. There are substantial costs we would
15 incur complying with those rules. It's not just
16 record keeping and reporting. You have potential
17 problems with respect to margin, capital, et
18 cetera. There's no cross reference that would
19 remove a physically subtle trade option from all
20 the other swap rules across the sphere of CFTC
21 reporting and record keeping, and any other rule
22 that refers to the term swap. So that's our real

1 concern with it.

2 I just wanted to thank Arushi and Paul
3 and Amy because I thought they did a great job on
4 presenting the current state of affairs, as far as
5 the industry thinks, with regard to trade options
6 and enumerating the concerns that we have, so I
7 appreciate it.

8 MR. ALLISON: Thank you. I wanted to
9 follow up on one of the points, and I have a hand
10 out. Ajay's got in his file and I'm assuming Ajay
11 can do whatever needs to be done to get it
12 officially into wherever the record ends up. I'm
13 very sensitive to the bad outcomes that have been
14 talked about from the current trade option rule,
15 not the proposed rule. I'm not sure I agree the
16 ambiguity. I think they're unambiguously bad
17 outcomes. Whether that's better or worse than
18 ambiguous bad outcomes I'm not sure.

19 The proposed trade option rule, from my
20 perspective, fixes almost all of those problems.
21 In the proposed rule, however, the Commission
22 declined to answer clearly the question of how

1 trade options would be treated in the position
2 limits rule. Many of us in our comments on that
3 proposed rule did comment that the final trade
4 option rule would be the correct place to address
5 the question of should trade options be within
6 scope of position limits. I believe it was
7 unanimous that we said, no, they should not be end
8 scope.

9 The question that I asked our folks to
10 take a look at is if trade options were in scope
11 for position limits how much would that add to our
12 cost to comply with a position limit rule? So
13 this is only the incremental compliance cost
14 associated with looking at trade options in
15 addition to everything else. So the trade
16 monitoring group within our compliance department
17 has taken a look at the processes they would have
18 to go through, and Page 2 of the handout lists the
19 various elements of the cost that would be
20 incurred. They looked at a minimum value and
21 expected value and maximum value. Page 3 then
22 shows the results of the simulation they ran. The

1 expected value of the costs we would incur on an
2 ongoing basis is a mean of about \$435,000 per
3 year, standard deviation about \$85,000, so call it
4 half a million dollars a year. That's per year
5 for one company in the trade options.

6 I would argue that the costs we incur
7 will probably be substantially lower than the
8 costs some kinds of market participants will occur
9 for one very good reason. If you look at the
10 detail on Page 2 of what drives the cost, the big
11 item is one we've labeled as trade option
12 identification. A big part of that is under the
13 position limit rules options have to be treated in
14 position limits on a delta equivalent basis. So
15 you have to be able to calculate the delta of the
16 option as it existed at close of business the
17 previous day. That delta equivalent of the option
18 is the contribution that option makes to your
19 position during the following business day. So
20 you have to calculate the delta of these options
21 every day during the spot period.

22 We can do that because we run these

1 options through our risk systems. We routinely
2 calculate deltas for them because that's how we
3 manage these positions. I am not at all sure that
4 an LCD or Linden Cogen or any of the other big
5 consumers that are the natural counterparts on
6 these options -- I am perfectly willing to believe
7 they know what delta is. I have no reason to
8 believe they bother to calculate delta on these
9 options because they have no need to. Linden has
10 to have these options. All they care about is do
11 I have to use the option today. Did my natural
12 gas supplier call me this morning and say they
13 were exercising one of those 22 days when they can
14 curtail me? If so, I have to exercise my option.
15 All they care about is the option exists when they
16 need it. They do not care about the delta.

17 So what is it going to cost them to put
18 in a system to calculate the deltas for these
19 things that they have never considered to be
20 options? So it costs us a non-trivial amount of
21 money at the margin as best we can estimate it. I
22 think our costs probably is a gross underestimate

1 of what it's going to cost a lot of market
2 participants. The market participants who have to
3 pay the most are those who are the natural users
4 of these to satisfy perfectly normal business
5 requirements such as the panel just described.

6 MR. COSGROVE: Jim and then Andrew.

7 MR. CATER: At the risk of belaboring a
8 point, I wanted to just emphasize the crucial need
9 for volumetric optionality in electricity supply
10 arrangements. As all three panel members have
11 indicated, an electric grid operator has to
12 balance the demand for electricity and the supply
13 of electricity instantaneously in real time and
14 there are no choices. If there are appreciable
15 deviations of supply relative to demand, either
16 too little supply or too much supply the lights
17 are going to go out, and that's just a matter of
18 physics.

19 This task of balancing demand and
20 supply, real time, it's become more, not less,
21 difficult. It's becoming more difficult. For one
22 reason is the society is tending to rely more on

1 renewable resources to provide its electricity,
2 primarily for environmental concerns. If you take
3 a typical renewable resource like solar
4 photovoltaics, for all its favorable attributes it
5 has one unfortunate characteristic and that is
6 it's intermittent, and it's intermittent in an
7 unpredictable way, so a solar panel can be
8 generating a good deal of electricity when the
9 sun's out on a hot day, and then a cloud comes
10 over and the demand for electricity is retained
11 because it's still hot and humid, but the solar
12 panel is no longer producing electricity because
13 of the cloud cover. That's an imbalance that has
14 to be made up and it has to be made up
15 instantaneously.

16 You have to have contracts that allow
17 you to do that. That's just one example of the
18 crucial need which, again, is going to grow more
19 not less troublesome because of this increased
20 reliance on renewable resources. Now, APPA, as
21 I'm sure the Commission knows, in conjunction with
22 other trade associations has commented on the

1 forward contract final interpretation and on the
2 TO NOPR, and there's much that we see that's
3 favorable in both of those, the NOPR and the final
4 interpretation. Particularly, the construction of
5 the seven factor test in the final interpretation,
6 but there are lingering issues. As we've said in
7 our comments we think the best way to address
8 these lingering issues would simply be what, in
9 our view would be consistent with the intent of
10 Congress, is to exclude these commodity trade
11 options from the definition of the swap. So
12 that's it.

13 MR. SOTO: I'd actually like to talk a
14 little bit of a step back, and I do so at the risk
15 of sounding a little bit like Oliver with his bowl
16 in hand, can I have some more? I know you're
17 probably feeling why aren't we done with this
18 issue given its history. It has a history in the
19 sense that, you know, you first started out with
20 saying, we'll look to our Brent interpretation and
21 you came up with the three part test. The second
22 of which called into question any contract that

1 had variability as to the delivery time. That, of
2 course, threw the industry for a loop because one
3 of the great values and the tremendous benefits of
4 competition, especially in the natural gas
5 industry over the last 30 years is not just the
6 price effects of competition, but it's the
7 innovation of the services.

8 There's been a tremendous amount of
9 variability and tailored products to meet specific
10 needs all because of the well head decontrol and
11 competition. The industry, understandably, has
12 some angst about are all these contracts not going
13 to be considered swaps? So then you came up with
14 the seven part test, but then you said, however,
15 and then had another three part test. The general
16 council had to come in and give you a five part
17 test to explain why the however you shouldn't
18 worry about. Now, well maybe there's a trade
19 option avenue that we can deal with.

20 We're all kind of a little confused.
21 Every time that you make a release or a guidance
22 or another iteration of the rule it seems to raise

1 more questions than it answers. We can talk about
2 are these forwards? We can talk about are these
3 options? Are they trade options and where do they
4 fall? We just don't want them to be swaps. These
5 are intended to be physically settled. We thought
6 we convinced you of that in one of the iterations
7 of this. I think we shouldn't lose sight of where
8 we eventually end up, and that is that we
9 shouldn't lose the innovation in the marketplace
10 that's available by creating a doubt as to whether
11 these are swaps. So whatever clarify you can
12 provide to the industry on that issue just make
13 sure that they're not going to be regulated as
14 swaps. Thank you.

15 MR. COSGROVE: Paul?

16 MR. HUGHES: Just for a little bit of
17 clarity. What we're really talking about are firm
18 contracts that are still options. We're talking
19 about options for firm delivery, firm settlement.
20 So there is no question whatsoever that
21 settlement's going to occur. It's the only way
22 that it can incur physically. We say intended to

1 be physically settled. It's the only way that it
2 can happen. This has been the case on the power
3 side. You have to have capacity.

4 So if I contract and I have an option
5 for 500 megawatts somebody has to reserve that
6 capacity for me, they're interlinked. It's not
7 just a standalone. Secondly, that has to occur
8 regardless of the financial implication. So it's
9 just a reminder, we don't exercise these options
10 or these agreements when they're "in the money or
11 out of the money." That is not what is driving
12 our decision making.

13 The same really holds true for me in the
14 natural gas agreements we've heard. Even though
15 I'm speaking as Southern Company, the gas just
16 doesn't come out of the air. If it's a firm
17 agreement that has to be reserved somewhere. We
18 bat along a lot the idea of, kind of, the
19 Enterprise Rental Car example. So I call
20 Enterprise Rental Car they come drop off a car.
21 I've got it in my parking lot. Okay. They've
22 delivered the capacity for me to drive wherever I

1 need to drive. I might choose not to go anywhere
2 because it's too hot outside. I don't want to go
3 anywhere. Gas -- whatever. But that doesn't mean
4 that I did not receive that capacity. It doesn't
5 mean that I haven't already received it.

6 I think that example holds true both on
7 the power and the gas side. I think the concerns
8 you hear are the same ones. I mean, this is one
9 of those topics where we've been kind of saying
10 over and over again and you kind of want to have
11 everybody have a T-shirt, if you're argued about
12 trade options before you get a free T-shirt or
13 something like that. But at the end of the day,
14 we're all still talking about a physically settled
15 agreement. I think the biggest frustration we may
16 have is if there's one area where it feels like we
17 may have talked past each other this may be it.

18 So what I'm really asked for, I can't
19 speak for everybody else, is an acknowledgment
20 that we can use facts and circumstances, which I
21 think are there in the industry as a whole, to
22 help us kind of cross the bridge and not end up

1 with a swap.

2 MR. COSGROVE: Amy.

3 MS. FISHER: So I just wanted to comment
4 on what Paul said. The one thing that we really
5 don't need, I think, is another circular
6 discussion that leaves us, at least in my case,
7 with a prong 2 problem in the seven part test. I
8 think there needs to be some specific
9 acknowledgement that zero delivery is contemplated
10 by the seven part test or some other type of
11 acknowledgement that these types of contracts are
12 not swaps.

13 MR. COSGROVE: Yes?

14 MS. SHARMA-FRANK: I just think it bears
15 repeating that every time there is a no issuance
16 there is a very serious and meaningful look by the
17 end user marketplace to see how we can get to
18 where we want to be. The reason you have
19 uncertainty is not just because the rules
20 themselves may be unclear, but may be unclear how
21 you apply them to the various types of contracts
22 out there, and then disagreement on how you apply

1 it. So to the extent we want something in terms
2 of our clarity in the trade option rule we're
3 looking for very clear statements that can be used
4 to strengthen that bridge and we can walk across
5 it ourselves. That's what's been happening, back
6 and forth, back and forth. Counterparties are
7 negotiating these deals and coming up with
8 solutions based on what they have.

9 But the resources, the time, the amount
10 of uncertainty, the fact that you may go out into
11 the marketplace and not get that supply because
12 there's no one willing to do that firm call deal
13 with you. That's a lot to take in and realize
14 that you've got lots of words on paper, but
15 there's something else we need. To the extent
16 that on our slides were in the comment record,
17 there are proposed ways to just immediately center
18 on this issue and discuss it in full detail in the
19 TO docket. I think that's going to be very
20 helpful because it's going to mirror very closely
21 the work the Commission's already done in the EVO
22 docket, volumetric optionality docket.

1 The final interpretation says very
2 clearly in the very last paragraph, in response to
3 a request for a no action relief and guidance from
4 energy associations that was filed in the same
5 time period as those comments that there is, on
6 the basis of that final interpretation, good
7 reason and it is permissible and expected that the
8 industry will go out and look at what's being
9 potentially misreported as trade options and
10 reclassify or develop nomenclature that would take
11 those contracts or those arrangements out of the
12 trade option world. So you have that language in
13 the very last paragraph of the embedded volumetric
14 optionality interpretation.

15 With the proposed TO language out there,
16 to the extent there's any uncertainty created
17 either by what was not in the interpretation,
18 what's not in the proposal, or by any of the
19 issues that were raised in concurrence to that
20 proposal those can be resolved. Then we'll mirror
21 what the Commission's already done. So in short
22 form, seal the deal. Make it easy for us to take

1 what the Commission's issues and walk that bridge,
2 and come up with the right answer.

3 MR. COSGROVE: Well, as there appear to
4 be no further questions and it's getting to be
5 late in the afternoon, and we've had wonderful
6 information from this panel and the previous
7 panels. I'd like to hand it over to Commissioner
8 for closing remarks.

9 COMMISSIONER GIANCARLO: On behalf of my
10 fellow commissioners and I, I want to thank you
11 all for being here. I think that you can see by
12 the attendance of the full Commission here for
13 most of the day we take the comments made very
14 seriously. We thank you all for the work that
15 went in to putting these together. Thank you for
16 coming today. Thanks very much.

17 (Whereupon, the PROCEEDINGS were
18 adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Stephen K. Garland, notary public in
and for the District of Columbia, do hereby certify
that the forgoing PROCEEDING was duly recorded and
thereafter reduced to print under my direction;
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under penalty of perjury; that said transcript is a
true record of the testimony given by witnesses;
that I am neither counsel for, related to, nor
employed by any of the parties to the action in
which this proceeding was called; and, furthermore,
that I am not a relative or employee of any
attorney or counsel employed by the parties hereto,
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My Commission Expires: May 31, 2018

