

The Commodity Futures Trading Commission Proposes Federal Position Limits on Energy Commodities

On January 14, 2010, the Commodity Futures Trading Commission (CFTC) issued a Notice of Proposed Rulemaking (NOPR) to establish “Federal Speculative Limits for Referenced Energy Contracts and Associated Regulations.” If finalized, the rulemaking will represent the first time that the CFTC would directly impose Federal position limits for the referenced energy commodities.

The proposal would: (i) establish Federal position limits for specific energy commodities traded on CFTC-regulated markets; (ii) propose categories of exemptions from the Federal position limits; and (iii) impose specific reporting requirements governing specific positions and exemptions.

Comments to the NOPR are due by April 26, 2010.

BACKGROUND

The CFTC currently does not impose position limits for energy commodities. Rather, futures and options in energy commodities, which are largely traded on the New York Mercantile Exchange (NYMEX) and the Intercontinental Exchange (ICE), are subject to exchange-imposed position accountability rules in the single-month and all-months-combined (AMC) as well as position limits in the spot month. The CFTC imposes Federal position limits for certain agricultural commodities in each of the spot month, single-months and AMC.

The CFTC held public hearings over three days in July and August of 2009 to consider setting Federal position limits for specific energy commodities as a means to address excessive speculation, large concentrated positions, and price volatility in the underlying commodities. Four of the five CFTC Commissioners voted to issue the NOPR (Commissioner Jill Sommers dissented) on January 14, 2010.

COVERED ENERGY COMMODITIES

The NOPR proposes Federal speculative position limits for exchange-listed futures and options contracts in the following commodities: natural gas, crude oil, heating oil, and gasoline. Specifically, the position limits would apply to referenced futures and options contracts that include, or are based on: Henry Hub natural gas (NG), Cushing light sweet crude oil (CL), New York Harbor No. 2 heating oil (HO) and New York Harbor gasoline blendstock (RBOB). Under the proposed regulations, no person may hold or control positions in the referenced energy contracts that are in excess of the Federal position limits, unless the person seeks and receives an exemption from the limits.

The proposed Federal position limits would supplement the position limits and position accountability rules currently imposed by the regulated exchanges, such as NYMEX and ICE.



FEDERAL POSITION LIMITS

The NOPR proposes to establish both aggregate and reporting-market (market-specific) Federal position limits. The aggregate limits would cover positions in the referenced energy commodities across physically-delivered and cash settled contracts and across reporting markets. The market-specific limits would apply to positions in contracts that are in the same class, which would include contracts (in the referenced energy commodities) that are economically highly similar, traded on a single reporting market, based on the same commodity, and settled in the same manner (cash settled or physically delivered). During the spot month, contracts must also expire on the same day in order to be deemed contracts of the same class.

In implementing each of the aggregate and market-specific limits, the NOPR proposes limits in the AMC and single-month (for positions held outside the spot month), in addition to spot month limits. Once established, the position limits would be reset by the Commission by January 31st of each calendar year.

The proposed rule also includes account aggregation standards for purposes of determining a trader's overall position in the referenced energy contracts for accounts that are owned indirectly or jointly.

EXEMPTIONS

The NOPR proposes specific exemptions from the position limits for: (i) bona fide hedging transactions, (ii) certain swap dealer risk management transactions, and (iii) positions that would remain in compliance with the applicable limits after option contracts, comprising of a portion of overall position, are delta-adjusted by a "contemporaneous risk factor." The NOPR also proposes procedures for applying for exemptions, along with specific reporting requirements applicable to the exemptions described above, and in connection with specific positions in the referenced energy contracts.

Van Ness Feldman continues to monitor the development of the proposed rules and the impact they may have on the energy industry.

FOR ADDITIONAL INFORMATION

Van Ness Feldman regularly counsels clients on regulation of energy transactions. Van Ness Feldman is also actively engaged in the ongoing policy debates concerning reforms to the financial regulatory system (e.g., proposals to regulate the over-the-counter derivatives markets) as they relate to the energy sector. If you are interested in additional information regarding the CFTC's NOPR or other financial reform initiatives, please contact Curt Moffatt at (202) 298-1885, John Buchovecky at (202) 298-1887, or Nadia Zakir at (202) 298-1831.

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