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July 13, 2009

Mr. David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

COMMENT

Received CFTC
Records Section
7/14/09

Re: The Commodity Futures Trading Commission (''CFTC'' or "Commission") review to determine whether the Henry Financial LD1 Fixed Price contract, traded on the IntercontinentalExchange, Inc. ("ICE"), an exempt commercial market (''ECM'') under sections 2(h)(3)–(5) of the Commodity Exchange Act (''CEA'' or the ''Act''), performs a significant price discovery function.

Dear Mr. Stawick:

Steel Manufacturer's Association ("SMA") and East Texas Electric Cooperative, ("ETEC") (collectively referred to as "SMA and ETEC") submit this letter in response to the CFTC's invitation for comments reported in 74 Fed. Reg. 28028.

The members of SMA and ETEC regularly enter into power purchase agreements and hedges, which are largely or directly based on the price of natural gas. ETEC and its members regularly execute physical and financial natural gas transactions. The members of SMA and ETEC are substantially affected by disproportionate financial "investment" in natural gas commodities to the extent that such investment creates periods of excessive prices and increased volatility. SMA and ETEC submit that this natural gas investment is enabled and driven, in part, by natural gas transactions executed on ICE, and take this opportunity to respond to the Commission's request for comments. In the request for comments, the CFTC provided:[1]

In determining whether an ECM's contract is or is not a [Significant Price Discovery Contract ("SPDC")], the Commission will consider the contract's material liquidity, price linkage to other contracts, potential for arbitrage with other contracts traded on designated contract markets or derivatives transaction execution facilities, use of the

[1] Regarding the Commission's request for capacity in which the commenter is knowledgeable on the subject, the primary author of these comments formerly practiced as a commodities compliance vice president for a reputable dealer that traded substantially on ICE and NYMEX. The author also investigated multiple natural gas and derivative products related market issues as a FERC enforcement attorney and SEC Economist and currently provides legal advice on the negotiation of physical and financial natural gas and power transactions as an attorney for Brickfield Burchette Ritts & Stone., PC.

ECM contract's prices to execute or settle other transactions, and other factors... The Commission will publish a notice to receive written data, views, and arguments relevant to its determination from the ECM and other interested persons.[2]

SMA and ETEC provide these comments, along with late filed comments submitted under 74 Fed. Reg. 12282 regarding the Concept Release on a new Limited Risk Management Exemption from Speculative Position Limits ("Concept Release"). SMA and ETEC submit that this LD1 review and Concept Release are interrelated, as we will explain below. We support recognition of LD1 as an SPDC, which should be subject to increased oversight by the Commission, and particularly, to position limits.

Specifically, to the extent the CFTC determines to extend position limits and implement the Limited Risk Management Exemption to natural gas commodities, such as NYMEX's NG1 ("NG1"), such a determination will likely shift liquidity from NG1 to LD1, as a means to avoid newly enacted position limits, unless the Commission also subjects LD1 to position limits applicable to SPDCs under the Core Principles applicable to SPDCs.[3] SMA and ETEC would like to highlight this risk and ask that it be considered in the CFTC's evaluation.

The need for this expansion of CFTC oversight arises due to the sophistication of fund managers and the breadth of financial "investment" in natural gas commodity products. The CFTC needs the ability to aggregate positions of specific non-commercial market participants across all exchanges that make substantial markets in natural gas. Without this ability, speculative traders with outsized positions will shift into markets where they have yet to reach a position limit, or to a market that has no limit at all. All exchanges that maintain a significant market share of the natural gas commodity should be subject to these limitations.

Gaming across exchanges, or the intention to do so, was made patently clear when *Platts Gas Daily* reported the comments of John Hyland, the portfolio manager and chief

[2] 74 FR 28028, 28029 (June 12, 2009).

[3] 17 CFR 36, Appendix B to Part 36—*Guidance on, and Acceptable Practices in, Compliance With Core Principles:* Core Principle of Section 2(h)(7)(C)—Position Limitations or Accountability. The electronic trading facility shall adopt, where necessary and appropriate, position limitations or position accountability for speculators in significant price discovery contracts, taking into account positions in other agreements, contracts and transactions that are treated by a derivatives clearing organization, whether registered or not registered, as fungible with such significant price discovery contracts to reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month.

investment officer of United States Natural Gas Fund, LP ("UNG"), on May 22, 2009.[4] The natural gas newsletter reported that "Hyland told Platts earlier this week that if NYMEX asked the fund to reduce its percentage of open interest, it could move positions to ICE."[5] For these reasons, ICE Henry Hub natural gas products should also be subject to position limits and proposed limited risk management exemption rules.

Recent trading activity in UNG created concerns for SMA and ETEC regarding excessive speculation. The explosion in UNG volume that started in April 2009 and peaked in June 2009 correlated well with excessive volatility and price increases. These exchange traded security volumes represent a significant portion of both ICE and NYMEX open interest.[6] Trading activity during this period reversed a period of decline in the natural gas markets, despite continued fundamental weakness -- record storage, strong production and substantial excess production capacity.

This UNG activity provides a textbook case on the ability of a single commodity "investment" product to impact the price of natural gas on the NYMEX and ICE. On July 9, 2009, *Platts Gas Daily* reported rather dramatic comments by traders relating to the Security and Exchange Commission's ("SEC") failure to approve the UNG's issuance of more shares:[7]

> The fund, which warned in a Securities and Exchange Commission filing Monday that it faced running out of registered units if the SEC did not approve its June 5 new-registration request, did just that Tuesday, leading the New York Stock Exchange to order a 45-minute trading halt for UNG while the fund provided the SEC more information. Several traders noted an immediate drop in the August NYMEX gas futures contract, which slid 8.2 cents in the last hour of trading. "You saw such a bearish reaction immediately," a Houston-based NYMEX trader said. "Big black box funds are ready to start arbitraging this."

[4] *See* UNG Prospectus (May 6, 2009). UNG is a commodity pool and an exchange traded security. The investment objective of UNG is to have the changes in percentage terms of the units' net asset value reflect the changes in percentage terms of the price of natural gas delivered at the Henry Hub, Louisiana, as measured by the changes in the price of the futures contract on natural gas traded on the New York Mercantile Exchange that is the near month contract to expire, except when the near month contract is within two weeks of expiration, in which case it will be measured by the futures contract that is the next month contract to expire, less UNG's expenses.

[5] NYMEX keeping eye on heavily traded gas fund, Platts Gas Daily (Platts), May 22, 2009 p. 7.

[6] *Id.*

[7] Traders watch NYMEX for sign of gas fund's impact, Platts Gas Daily (Platts), July 9, 2009 p. 3.

> Speculation of another large drop Wednesday materialized to some degree as the contract closed another 7.6 cents lower… [Sempra's Brison] Bickerton said the halt of new capital into UNG could have a longer-term bearish effect on prices. "Getting a 7-cent sell-off despite weather maps that are a little bit warmer is impressive. It says that the market is selling off in the face of UNG." Stephen Schork, president of Schork Group, agreed, saying he believes the lack of new money will have a bearish effect on gas prices. "Wall Street has been selling [UNG] since the winter, and the clients don't have much to show for it so far. Perhaps this is the breather they need to step back and realize just because a commodity is cheap doesn't mean it has to get expensive," Schork said. "If we take out this lift that UNG could have been providing the market, you could very well see this flush down below $3."
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> A recent report from Credit Suisse said the vacuum created by UNG's sudden absence would lead to continued downward pressure on prices, and that many UNG investors may take this opportunity to divest themselves. "That bid is going to be missing from the futures market now. You've filled up a bag and you can't put any more in it. It's a very bearish dynamic," a Houston based NYMEX trader added.
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> But according to Bickerton, the real impact will come when the SEC makes a ruling on whether UNG gets its new units. "It could spark a major short-covering market," Bickerton said. "If the market postulates that big volumes are on the way, you [might] have a rip-your-face-off short-covering rally. It's kind of a scary thought."

These comments, in summary, indicate that the lack of additional gas purchasing by UNG, due to SEC restrictions, generated significant bearish sentiment, and caused natural gas prices to fall substantially. If the comments of the various market participants in the excerpt above are accurate, the UNG exchange traded security created excessive volatility and temporarily increased prices above levels suggested by economic fundamentals.

Due to the clear price impact of UNG on the natural gas markets currently, it must be the case that UNG's primary hedging tools would generate significant price discovery. To the extent UNG relies on LD1 to effect its hedging, this supports the significance of LD1 as an SPDC. The latest UNG posting of its natural gas commodity positions reflects a majority of natural gas product open interest as held on ICE in LD1 when compared to NYMEX futures.[8]

Daily Holdings

As of 7/10/2009

Current Holdings *(subject to change)*				
Type	**Security**	**Quantity**	**Price**	**Market Value**
Natural Gas Futures and Other Natural Gas Interests	NYMEX Nat. Gas Future NG Aug09	27,203	3.373	917,557,190
	ICE Nat. Gas Cleared Swap ICE LOT Aug09	339,234	3.373	2,860,590,705
	NYMEX Nat. Gas Future NN Aug09	51,746	3.373	436,348,145

Based on the above, whether investors in UNG consisted of sophisticated funds, or a herd of individual investors, these financial investors significantly impacted natural gas prices via hedges with LD1. SMA and ETEC support subjecting all natural gas investment vehicles to aggregate position limits and the proposed limited risk management exemption. The recognition of LD1 as an SPDC is an important step toward achieving that goal.

In addition to the current lack of CFTC based position limits on exchange traded natural gas commodity products, UNG benefits from CFTC no-action letters that indicate the CFTC will not subject commodity pools similar to UNG to position limits.[9] Based on impact of UNG, SMA and ETEC also request the CFTC to reconsider this exemption from position limits provided to the Commodity Index exchange traded securities.

In summary, the CFTC should extend application of position limits and implement the proposed limited risk management exemption considered under the

[8] UNG Daily Holdings, United States Natural Gas Fund, LP *available at* http://www.unitedstatesnaturalgasfund.com/ung_holdings.asp
[9] *See* CFTC Letters 06-09 (May 5, 2006) and 06-19 (September 6, 2006).

Concept Release to LD1. This extension would enable the CFTC to aggregate positions of specific non-commercial market participants across significant natural gas exchanges and prevent excessive speculation from creating market dislocations. Due to the excessive impact of UNG on the price of natural gas through NG1 and LD1, and for consistency and equity, the CFTC should also reconsider no-action relief granted to exempt commodity index funds from position limits.

Sincerely,

Peter G. Haller
Counsel for SMA and ETEC