From: Soto, Andrew <ASoto@aga.org>
Sent: Monday, April 26, 2010 9:44 AM
To: secretary <secretary@CFTC.gov>
Cc: Sherrod, Stephen <SSherrod@CFTC.gov>; Van Wagner, David <dvanwagner@CFTC.gov>; Heitman, Donald H. <dheitman@CFTC.gov>; Fekrat, Bruce <bfekrat@cftc.gov>; Berkovitz, Dan M <DBerkovitz@CFTC.gov>
Subject: Federal Speculative Position Limits, RIN 3038-AC85
Attach: 100426 AGA Comments on Position Limits.pdf

David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 212st Street, NW
Washington, DC 20581

Re: *Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations*, 75 Fed. Reg. 4,144 (Jan. 26, 2010), RIN 3038-AC85.

Dear Mr. Stawick:

Attached for filing in the above-referenced rulemaking proceeding, please find the Comments of the American Gas Association.

Thank you for your consideration. If you have any questions regarding this filing, please feel free to contact me.

Sincerely,

Andrew K. Soto

AGA

Andrew K. Soto | Senior Managing Counsel, Regulatory Affairs
American Gas Association
400 N. Capitol St., NW | Washington DC 20001
202.824.7215 | asoto@aga.org | fax 202.824.9086
cell 703.975.4022 | www.aga.org

- Clean Fuel Green Fuel –

UNITED STATES OF AMERICA
BEFORE THE
COMMODITY FUTURES TRADING COMMISSION

Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations	))	RIN 3038-AC85

COMMENTS OF THE
AMERICAN GAS ASSOCIATION

Pursuant to the Notice of Proposed Rulemaking ("NOPR") issued January 14, 2010,[1] by the Commodity Futures Trading Commission ("CFTC" or "Commission") in the above-referenced proceedings and the section 13.4 of the Commission's regulations,[2] the American Gas Association ("AGA") respectfully submits these comments. AGA supports the Commission's efforts to ensure that the financial markets related to energy commodities function efficiently, and urges the Commission to protect the ability of commercial hedgers to engage in risk management transactions for the benefit of American energy consumers. AGA urges the Commission to allow entities with sufficiently separate and independent trading activities to obtain their own hedging exemption. AGA also recommends that the Commission conduct a study after the regulations have been in place for one year to determine whether the financial markets continue to function efficiently and there are adverse unintended consequences associated with the final rules in this proceeding.

[1] *Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations*, 75 Fed. Reg. 4,144 (Jan. 26, 2010).
[2] 17 C.F.R. § 13.4 (2009).

I. COMMUNICATIONS

All pleadings, correspondence and other communications filed in this proceeding should be served on the following:

Andrew K. Soto
American Gas Association
400 North Capitol Street, NW
Washington, DC 20001
(202) 824-7215
asoto@aga.org

II. IDENTITY AND INTERESTS

The AGA, founded in 1918, represents 195 local energy companies that deliver clean natural gas throughout the United States. There are more than 70 million residential, commercial and industrial natural gas customers in the U.S., of which 91 percent — more than 64 million customers — receive their gas from AGA members. AGA is an advocate for local natural gas utility companies and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international gas companies and industry associates. Today, natural gas meets almost one-fourth of the United States' energy needs.[3]

AGA members engage in financial risk management transactions in markets regulated by the Commission, including the trading of the contracts at issue in this proceeding. AGA members will be directly affected by the proposed regulations. Accordingly, AGA has a substantial interest in the outcome of this proceeding.

III. COMMENTS

A. Introduction

The NOPR in this proceeding proposes to establish position limits for trading of futures and options contracts related to a defined set of energy commodities. The referenced energy

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[3] For more information, please visit www.aga.org.

contracts under the proposed regulations include the New York Mercantile Exchange Henry Hub natural gas contract and any other contract that is exclusively or partially based on natural gas deliverable at the Henry Hub, which would include the Intercontinental Exchange Henry Financial LD1 Fixed Price natural gas contract. The proposed regulations would establish aggregate and exchange-specific limits for spot-month positions, single month and all-months-combined positions in the referenced contracts. Under the regulations, the Commission would administratively set these limits each year based on the formulas set forth in the regulations.

The proposed regulations would provide position limit exemptions for, among other things, *bona fide* hedging transactions as defined and approved by a reporting market in a manner consistent with sections 1.3(z)(1) and (2) of the Commission's regulations. Under the proposed regulations, a trader holding positions in excess of the position limits pursuant to a *bona fide* hedge exemption would generally be prohibited from also trading speculatively. The NOPR provides that traders holding positions in the spot month under a *bona fide* hedge exemption would not be prohibited from holding positions speculatively outside the spot month.

B. The Commission Should Ensure That Energy Markets Deliver Benefits To Consumers.

AGA member companies participate in physical and financial natural gas markets on behalf of themselves and their end-use customers. Each year natural gas utilities develop plans to reliably meet the gas supply needs of their end-use customers. Gas utilities build and manage a portfolio of physical supply, storage and transportation services in order to meet anticipated demand. These physical commodity contracts contain diverse contractual and pricing arrangements.

The cost and price risks associated with the portfolio of physical transactions to meet gas supply needs are ultimately borne by end-use customers. Gas utilities pass through the commodity-related costs of providing service directly to their retail customers through purchased gas adjustment clauses approved by state regulators. Nonetheless, gas utilities have a strong interest in managing their gas supply portfolios to ensure that the overall price for natural gas service remains stable and affordable. Price volatility – sudden increases in price in particular – present significant challenges for both consumers and the gas utilities that serve them. In high or volatile gas price environments, consumers, utilities and regulators all seek assurance that the natural gas prices they pay are the result of legitimate supply and demand fundamentals and are not the product of price manipulation.

Gas utilities seek to manage price volatility through a variety of financial instruments, such as futures contracts traded on CFTC-regulated exchanges and in particular the futures contracts at issue in the NOPR. Gas utilities use a variety of financial tools to manage price risks on behalf of their end-use customers. In a recent survey, more than 89 percent of the AGA members responding to the survey indicated that they use financial instruments, including futures, options, and swaps, to hedge at least a portion of their gas supply purchases. In that regard, the financial activities of gas utilities would properly be characterized as *bona fide* hedging transactions and positions as defined in sections 1.3(z)(1) and (2) of the Commission's regulations. They are often futures contracts on CFTC-regulated exchanges that do not exceed in quantity the fixed-price sale of the same cash commodity or the unfilled anticipated requirements of the same cash commodity.[4] These commercial hedging activities aid in reducing price volatility to end-use customers.

The financial markets related to natural gas commodities should continue to function effectively for the benefit of end-use customers. The Commission should see that the markets

[4] *See* 17 C.F.R. §1.3(z)(2)(ii).

are transparent and liquid and provide adequate opportunities for commercial entities to lay off risk to those better suited to bear it. AGA supports efforts by the Commission to ensure that financial markets are free from manipulation and unburdened by non-transparent systemic risks. AGA believes that position limits can benefit consumers by preventing a single trader from gaining such a large position that it has the ability or incentive to manipulate the market or that it creates systemic risk if the trader defaults.

The Commission should be careful, however, to protect the ability of gas utilities to engage in commercial hedging activities on behalf of their customers. The Commission should fully understand the potential consequences of its regulatory proposals and avoid rules that may impose additional costs on consumers or expose them to additional price risk. In that regard, AGA recommends that the Commission, as part of the final rule in this proceeding, direct its staff to conduct a study within one year following the effective date of the regulations to determine whether the financial markets related to the referenced energy commodities continue to function efficiently for the benefit of consumers, whether the position limits established as part of this proceeding are operating as intended to prevent market manipulation, and whether there are adverse unintended consequences associated with the final rule.

C. The Commission Should Provide For Exemptions for Affiliates That Trade Separately.

Under the proposed regulations, the position limits would apply, among other things, to all positions in accounts in which the person has an ownership or equity interest of 10 percent or greater. This requirement as applied to gas utilities may create significant compliance issues. Not all gas utilities are stand-alone entities. Rather, gas utilities are often affiliates of or owned by entities that control other energy-related firms. For example, many gas utilities are affiliated with electric utilities, either owning or owned by the electric utility or as a separate division within the same company (combination utilities). In addition, some gas utilities are affiliated with or owned by entities that control natural gas exploration and production companies (integrated utilities). In these companies, the gas utility may engage in commercial hedging activities on behalf of its end-use customers, while the affiliated electric utility may use financial transactions to hedge the purchase of natural gas for its gas-fired electric generation facilities, or the exploration and production company may use financial transactions to hedge its sales of natural gas. Moreover, gas utilities may have or be affiliated with an independent trading arm that engages in speculative trading activities.

A gas utility with commercial hedging activities that are sufficiently separate and independent from those of its affiliates should be able to obtain its own hedging exemption. In establishing position limits with respect to agricultural commodities, the Commission has provided an exemption for positions carried in the separate account of an independent account controller, and has allowed such independent account controllers to operate on behalf of affiliates where there are sufficient procedures in place to preclude the affiliated entities from having knowledge or access to the trades of the other.[5] The NOPR has not demonstrated that an exemption for independent account controllers is appropriate in the context of certain agricultural commodities but not for the energy commodities at issue in this proceeding. Thus, AGA urges the Commission to modify its proposed regulations in Part 151 to provide for an exemption for independent account controllers similar to that afforded in Part 150 of its regulations.

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[5] *See* 17 C.F.R. § 150.3(a)(4).

IV. CONCLUSION

Wherefore, for the reasons stated above, the American Gas Association respectfully requests that the Commission consider these comments in this proceeding.

Respectfully submitted,

/s/ Andrew K. Soto

Andrew K. Soto
American Gas Association
400 N. Capitol Street, NW
Washington, DC 20001
(202) 824-7215
asoto@aga.org

April 26, 2010