

**UNITED STATES OF AMERICA  
BEFORE THE  
COMMODITY FUTURES TRADING COMMISSION**

End-User Exception to Mandatory Clearing of Swaps           )           RIN 3038-AD10

**COMMENTS OF THE  
AMERICAN GAS ASSOCIATION**

Pursuant to the Notice of Proposed Rulemaking (“NOPR”) noticed in the Federal Register on December 23, 2010,<sup>1</sup> by the Commodity Futures Trading Commission (“CFTC” or “Commission”), the American Gas Association (“AGA”) respectfully submits these comments. AGA believes that the Commission’s rulemakings to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)<sup>2</sup> should ensure that the financial markets related to energy commodities function efficiently and protect the ability of commercial hedgers to engage in risk management activities at reasonable cost for the benefit of American energy consumers.

**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](mailto:asoto@aga.org)

---

<sup>1</sup> *End-User Exception to Mandatory Clearing of Swaps*, 75 Fed. Reg. 80,747 (Dec. 23, 2010).

<sup>2</sup> Pub. L. No. 111-203 (July 21, 2010).

## **II. IDENTITY AND INTERESTS**

The AGA, founded in 1918, represents 199 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.<sup>3</sup> AGA's members engage in financial risk management transactions in markets regulated by the Commission. As such, AGA's members will be directly affected by the Commission's regulations promulgated under the Dodd-Frank Act.

## **III. COMMENTS**

AGA member companies provide natural gas service to retail customers under rates, terms and conditions that are regulated at the local level by a state commission or other regulatory authority with jurisdiction. Many gas utilities use a variety of financial tools, such as futures contracts traded on CFTC-regulated exchanges and over-the-counter energy derivatives, to hedge the commercial risks associated with providing natural gas service, particularly volatility in natural gas commodity costs.

The Dodd-Frank Act requires swap transactions to be cleared with a derivatives clearing organization, but creates an exception from that requirement if one of the counterparties to the swap transaction is not a financial entity, is using the swap to hedge or mitigate commercial risk, and notifies the Commission how it generally meets its financial obligations associated with

---

<sup>3</sup> For more information, please visit [www.aga.org](http://www.aga.org).

entering into non-cleared swaps.<sup>4</sup> Congress intended to establish “a robust end user clearing exemption for those entities that are using swaps to hedge or mitigate commercial risk.”<sup>5</sup>

In the NOPR in this proceeding, the Commission proposes to implement this exception by requiring a counterparty that elects to use the exception to provide certain information to a swap data repository or to the Commission.<sup>6</sup> Such information would be required for each swap transaction for which the counterparty elects to use the exception.<sup>7</sup> The information must include: (1) the identity of the counterparty; (2) whether the counterparty is a financial entity; (3) whether the counterparty is a finance affiliate; (4) whether the swap is used to hedge or mitigate commercial risk; and (5) how the counterparty expects to meet its financial obligations associated with the non-cleared swap, *i.e.*, by means of a written credit support agreement, pledged or segregated assets, a written third-party guarantee, available financial resources, or some other means.<sup>8</sup> If more than one method is used to support meeting the financial obligations, information must be provided for each of the methods being used.<sup>9</sup> In addition, if the counterparty issues securities under Section 12 of the Securities Exchange Act of 1934 or is required to file reports with the Securities Exchange Commission under Section 15(d) of the Securities Exchange Act of 1934 (“SEC filer”), the information must include: (1) the relevant SEC Central Index Key number for the counterparty; and (2) whether an appropriate committee

---

<sup>4</sup> Dodd-Frank Act § 723.

<sup>5</sup> Letter from Senators Blanche Lincoln and Christopher Dodd, Chairs of the Senate Agriculture and Banking Committees, to Congressmen Barney Frank and Colin Peterson, Chairs of the House Financial Services and Agriculture Committee dated June 30, 2010 (“Dodd-Lincoln Letter”).

<sup>6</sup> Proposed 17 C.F.R. § 39.6(a).

<sup>7</sup> See 75 Fed. Reg. at p. 80,748.

<sup>8</sup> Proposed 17 C.F.R. § 39.6(b).

<sup>9</sup> See 75 Fed. Reg. at p. 80,749.

of the board of directors (or equivalent body) has reviewed and approved the decision not to clear the swap.<sup>10</sup>

AGA supports the proposed establishment of an end-user exception to the mandatory clearing requirement under the Dodd-Frank Act in order to allow gas utilities and other end-users to engage in risk management activities at reasonable cost for the benefit of consumers. AGA believes that the end-user exception should be robust and easy to implement. To that end, AGA offers the following recommendations to streamline the process whereby an end-user can rely on the exception to avoid the clearing and margin requirements.

In the NOPR, the Commission proposes to require an end-user to notify the Commission each time it enters into a swap transaction that the end-user elects not to clear.<sup>11</sup> The Dodd-Frank Act does not mandate that the Commission require such notification to be made for each such transaction. AGA is concerned that the process for notification as proposed may become administratively cumbersome and costly for end-users. Little or none of the information required to be submitted in the Commission's proposed process would change from swap transaction to swap transaction. Consequently, requiring end-users to establish their eligibility for the exception from mandatory clearing for each transaction is unduly burdensome and would provide little information of value to the Commission. Accordingly, AGA urges the Commission to allow end-users to provide the information necessary to establish eligibility only once annually, with updates whenever a material change occurs.

The identification information required by the Commission's proposed notice (*i.e.*, identity of the electing counterparty; whether the counterparty is a financial entity, and whether the counterparty is a finance affiliate) would change very infrequently and certainly not for each

---

<sup>10</sup> Proposed 17 C.F.R. § 39.6(b)(6).

<sup>11</sup> *See* 75 Fed. Reg. at p. 80,748.

transaction. Similarly, nearly all transactions executed by gas utilities are intended to hedge or mitigate commercial risk.

Moreover, the method by which the end-user expects to meet its financial obligations associated with the uncleared swap would generally not change with each transaction. Typically, gas utilities enter into master agreements with a counterparty that contain a credit support agreement. This credit support agreement would demonstrate how the gas utility expects to meet its financial obligations for each swap transaction under that master agreement, and the gas utility should be able to simply refer to this credit support agreement in its annual filing to satisfy the notice requirement. Detailed credit agreements cannot be and are not negotiated for each new transaction. To the extent a gas utility has negotiated other credit support with a counterparty, such as pledged or segregated assets, third-party guarantee, or available financial resources, the gas utility should also be able to disclose the existence of that negotiated agreement when it reports to the Commission on an annual basis. In all events, counterparties should not be required to negotiate new credit arrangements for each individual swap transaction in order to satisfy the notice requirements for the end-user exception. Such an interpretation is not mandated by the Dodd-Frank Act, and would impose significant administrative costs on end-users and their customers.

For those entities that are SEC filers, board authorization to enter into swap transactions does not change with each individual swap transaction. Many gas utility boards authorize their officers to enter into hedging transactions often within specified parameters. In some cases, a gas utility's board will approve an annual hedging plan and delegate its implementation to the company's management. In other cases, the board will authorize a risk oversight committee comprising company officers to review and oversee the financial risk management activities of

the utility. This committee will then review and approve detailed hedging or price mitigation plans that specify the types of transactions the utility may engage in to hedge its commercial risk. In these cases, the utility's officers and/or the risk oversight committee will report to the board on a periodic basis, at least annually, to ensure that the board remains informed of the hedging activities of the utility and has an opportunity to provide any necessary input on the utility's risk management plan.

In addition, a gas utility may not be the SEC filer but may be a subsidiary of a filer. Under the Commission's proposal a counterparty electing to use the end-user clearing exception would be considered to be an SEC filer if it is controlled by a person that is an SEC filer.<sup>12</sup> In those cases, the parent company's board would not review each hedging transaction of all of its subsidiaries. Rather, the subsidiary company's board would authorize its officers to enter into risk management transactions or establish a risk oversight committee to oversee the subsidiary's risk management activities.

In all events, gas utility boards do not authorize individual swap transactions. Decisions regarding whether to enter into an individual swap transaction, the terms of the transaction, and whether such transaction should be cleared on an exchange are generally made quickly based on prevailing economic conditions at the time.

As a result, a requirement that a utility's board must convene, review, and approve ahead of time each and every decision to enter into an uncleared swap transaction would be so administratively cumbersome as to preclude its use. Congress intended the end-user exception to be robust to allow end-users to continue to use swap transactions to hedge commercial risk without having to comply with all of the margin and collateral requirements imposed by an

---

<sup>12</sup> See 75 Fed. Reg. at p. 80,750 fn. 15.

exchange or clearinghouse. AGA contends that requiring prior board authorization to enter into each individual uncleared swap transaction is contrary to this express Congressional intent.

Rather than requiring prior board authorization for each uncleared swap transaction, the Commission should recognize the authorization granted by the end-user's board (or where appropriate the board of the subsidiary) to enter into risk management transactions that would utilize the end-user exception. In these circumstances, the Commission should be satisfied that the appropriate board would be kept informed of the hedging activities of the end-user and would have an opportunity to provide any necessary input on the risk management plan. The counterparties could enter into individual transactions, consistent with the end-user's risk management plan, without having to convene the board each time. Once an end-user has obtained the necessary board authorization, it should be able to rely on that authorization in order to satisfy the notice requirement under proposed § 39.6(b)(6)(ii).

#### **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](mailto:asoto@aga.org)

February 22, 2011