



AMERICAN PUBLIC GAS ASSOCIATION

February 22, 2011

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

Re: End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80,747, 17 CFR Part 39 (Dec. 23, 2010), RIN No. 3038-AD10.

Dear Mr. Stawick:

The American Public Gas Association ("APGA") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("Commission") proposed rules entitled, "End-User Exception to Mandatory Clearing of Swaps," 75 Fed. Reg. 80,747 (Dec. 23, 2010) ("Proposed Rules"). The Proposed Rules implement the "end-user clearing exception" of Section 2(h)(7) of the Commodity Exchange Act, 7 U.S.C. §1 *et seq.* (the "Act").

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"),¹ amended the Act to require that swaps be cleared through a derivatives clearing organization ("DCO"), unless eligible for an exception. Section 2(h)(7) of the Act provides that transactions in which at least one of the entities is a non-financial entity that is entering into the swap transaction to hedge or mitigate commercial risk will not be subject to the mandatory clearing requirement. The Proposed Rules delineate when a swap is used to "hedge or mitigate commercial risk" and sets out the specified information that must be provided to the Commission each time the end-user clearing exception is elected.

APGA has long been supportive of the Commission's efforts to bring greater transparency to the over-the-counter ("OTC") swaps markets, including advocating that large trader reporting and speculative position limits apply to OTC as well as the futures positions. We appreciate the Commission's efforts to build a comprehensive framework on the foundation of the Dodd-Frank Act.

APGA

APGA is the national association for publicly-owned natural gas distribution systems. There are approximately 1,000 public gas systems in 36 states and over 700 of these systems are APGA members. Publicly-owned gas systems are not-for-profit, retail distribution entities owned by, and

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank"). Section 723(a)(3) of the Dodd-Frank Act created the end-user exception.

accountable to, the citizens they serve. They include municipal gas distribution systems, public utility districts, and other public agencies that have natural gas distribution facilities.

APGA members regularly engage in swaps transactions to hedge or mitigate the risk of their purchase or sale of natural gas. These hedging activities assist APGA's members in maintaining long-term supplies of natural gas and enable them to mitigate price volatility in selling gas to their customers. APGA members are not "financial entities" as that term is defined by the Dodd-Frank Act.²

The Proposed Rules

The Dodd-Frank Act requires that, absent an exception, swaps will be subject to a mandatory clearing requirement. As noted, the Dodd-Frank Act establishes an "end-user" exception to that requirement. The Commission is proposing rules to implement the end-user exception to this mandatory clearing requirement. Proposed Rule 39.6 requires that an end-user electing to use the clearing exception must provide specified information to the Commission through a swaps data repository ("SDR"), including how the entity mitigates credit risk in connection with its non-cleared swaps. The end-user must also provide information to confirm its compliance with the requirements of the end-user clearing exception, including the identity of the party, if it is using the swap to hedge or mitigate commercial risk, and confirmation of board approval, if applicable.³

APGA's Comments on the Proposed Rules

Hedging or Mitigating Commercial Risk

APGA supports the Commission's broad definition of "hedge or mitigate commercial risk" in proposed Rule 39.6(c). Specifically, APGA supports the Commission's conclusion that "mitigation of commercial risk" is broader than the definition of "bona fide hedging" under Commission Rule 1.3(z) and covers swaps used to hedge or mitigate a person's business risk, as defined by six categories, regardless of their status as hedges under accounting rules.⁴ Further, we also agree with the Commission that mitigation of commercial risk may include trading activities that are more varied than those defined as "hedges" by accounting rules.⁵

APGA also specifically supports a broad understanding of risk mitigation which includes covering risk on an aggregate basis. Although individual members' hedging practices may vary, APGA members generally do not enter into hedging transactions on a one-for-one basis with their

² Section 2(h)(7)(C) of the CEA, as amended by the Dodd-Frank Act, provides that in general the term "financial entity" means a: swap dealer; security-based swap dealer; major swap participant; major security-based swap participant; commodity pool; private fund as defined in Section 202 of the Investment Advisers Act of 1940; employee benefit plan as defined by Section 3 of the Employee Retirement Income Security Act of 1974; or person predominantly engaged in activities that are in the business of banking or that are financial in nature under Section 4(k) of the Bank Holding Company Act.

³ The Commission must be notified if the entity seeking to use the exception is a registered issuer of securities, or if it is required to file reports with the Securities and Exchange Commission ("SEC"). This type of entity may use the exception only if its board reviewed and approved the decision to enter into swaps that are subject to the exception.

⁴ These relate to potential changes in the value of assets, liabilities, services, inputs, products, or commodities, as well as interest, currency, or foreign exchange rates) See Proposing Release note 6.

⁵ See FASB ASC Topic 815, Derivatives and Hedging (formerly known as Statement No. 133).

physical contracts. Rather, many, if not most, view their physical requirements for natural gas on an aggregate basis for the course of the heating season and hedge on an over-all basis. This comports with the risk mitigation procedures used by many market end-users. APGA's members believe that hedge effectiveness cannot be taken into account in determining whether the end-user qualifies for use of the end-user exception. Because hedge effectiveness is a backward-looking determination, the end-user would not be able to ascertain this at the time that it enters into a swap. It is important that both the end-user and its counterparty be able to ascertain the status of the transaction at contract initiation.

Notification provision

The Commission has proposed a check-off notification under the end-user exception. APGA does not object to this approach and recognizes that it may be administratively easier to manage than a self-contained periodic or even annual, filing. However, APGA believes that the proposed check-off notification would be less burdensome if it were included once, in the master-agreement between the two parties. The parties would be required to update the notice only for material changes thereto. As long as there were no changes, the general notice would remain in effect as first filed. An exception notice could be filed for any specific transaction that is not covered by the general end-user notice as part of the individual transaction confirmation. APGA believes that this solution would streamline the process of providing information to the Commission while accomplishing the statutory goals.

Conclusion

As APGA has noted in the past, natural gas is a lifeblood of our economy and millions of consumers depend on natural gas every day to meet their needs. It is critical that the price that those consumers pay for natural gas comes about through the operation of fair and orderly markets and through appropriate market mechanisms that establish a fair and transparent marketplace.

APGA commends the Commission's approach to broadly defining "mitigation of commercial risk" and recognizes that the check-off notification system has merit. We would suggest, however, that even this notification method could be further streamlined and still accomplish the statutory objectives.

We would be happy to discuss our comments at greater length with the staff. Please feel free to contact Bert Kalisch, President and CEO of APGA, David Schryver, Executive Vice President at 202-464-2742, or Paul M. Architzel of WilmerHale, outside counsel to APGA, at 202-663-6240.

Respectfully submitted,



Bert Kalisch
President & CEO
American Public Gas Association