AMERICAN PUBLIC GAS ASSOCIATION

February 22, 2011

Filed Electronically

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

Re: Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 75 Fed. Reg. 80638 (Dec. 22, 2010), RIN 3038-AD25.

Dear Mr. Stawick:

The American Public Gas Association ("APGA") appreciates this opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or the "Commission") proposed rules on business conduct standards for swap dealers and major swap participants[1] with counterparties (the "Proposed Rules").[2] We commend the Commission's efforts to implement the mandate of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). We are nonetheless concerned that aspects of the Proposed Rules may have the unintended consequence of reducing, rather than increasing, market transparency for "special entities." As discussed below, these proposed revisions may reduce the tools available to special entities and thereby lessen their ability to hedge efficiently and, as a consequence, result in increased costs for their customers.

Background

The APGA is a nonprofit trade organization that represents America's publicly-owned natural gas local distribution companies. APGA has over 700 members in 36 states that are owned by, and accountable to, the citizens they serve. Our members use swaps to hedge their exposure to variations in energy prices and mitigate the effects of such volatility on the consumers that use natural gas in their homes and businesses. As publicly owned entities, most, perhaps all, of APGA's members may be "special entities" within the meaning of section 4s(h)(2)(C) of the Commodity Exchange Act, 7 U.S.C. §1 *et seq*. (the "Act").

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[1] For textual clarity, we limit our comments in this letter to the proposed requirements for swap dealers. Our views on these requirements also apply, where applicable, to the analogous proposed requirements for major swap participants.

[2] *Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties*, 75 Fed. Reg. 80638 (Dec. 22, 2010) ("Proposing Release").

Comments on the Proposed Rules

APGA has long been supportive of the Commission's efforts to bring greater transparency to the over-the-counter swaps markets, including advocating that large trader reporting and speculative position limits apply to positions in the over-the-counter ("OTC") swaps markets as well as the futures markets. We appreciate the Commission's efforts to implement the new requirements for swap market participants and build a comprehensive framework on the foundation laid by the Dodd-Frank Act. In doing so, we believe that the regulatory goals of Dodd-Frank should be achieved in a way that will not cause significant impediments to the operation of the market. To achieve this goal, the Commission in its rules should recognize differences in the sophistication of various swap market participants, in particular, those that are "special entities."

We offer comments on several specific aspects of the Proposed Rules below.

A. Definition of Special Entity

Following the language of section 4s(h)(2)(C) of the Act, proposed Rule 23.401 would define "special entity" to include, *inter alia*, "[a] State, State agency, city, county, municipality, or other political subdivision of a State." APGA's members have a particular interest in understanding fully the entities that will be deemed special entities. Accordingly, we believe the Commission should clarify whether the proposed definition is intended to include non-enumerated governmental entities, such as instrumentalities of a state or of municipalities, or public corporations.[3]

This requested clarification is necessary, particularly in light of the references to "municipal entities" in other rules proposed by the Commission. For example, proposed Rule 23.450(b) (discussed in more detail below) would require "municipal entities" to impose pay-to-play rules on their independent representatives. The term "municipal entity" is defined in proposed Rule 23.451 to include "any State, political subdivision of a State, or municipal corporate instrumentality of a State, including…[a]ny agency, authority, or instrumentality of the State, political subdivision, or municipal corporate instrumentality." This definition differs from the definition of "special entity" in Dodd-Frank and the Proposed Rules. Thus, it is unclear whether all "municipal entities" or instrumentalities of a State are intended by the Commission to be deemed "special entities" for purposes of the proposed business conduct standard rules.

B. Verification of Counterparty Eligibility

Proposed Rule 23.430 would require swap dealers, before offering to enter into or entering into any swap transaction, to verify that their counterparty meets the eligibility standards for eligible contract participants and whether the counterparty is a special entity. The discussion in the Proposing Release states that the counterparties can make the required representation as

[3] Such entities may or may not be "political subdivisions of a State" under the applicable law of the State.

part of the master agreement.[4] For clarity, we suggest that the Commission include this proviso in the text of the rule itself.

C. Disclosure of Material Information

Under proposed Rule 23.431, swap dealers would be required to disclose to a counterparty to a swap transaction material information concerning the swap designed to allow the counterparty to assess the risks of the swap. The disclosure would be required at a "reasonably sufficient time prior to entering the swap."

Because of the likely importance of this provision to the compliance programs of swap dealers and Major Swap Participants ("MSP"), APGA requests that the Commission provide more specificity as to when, exactly, the disclosures would have to occur. APGA does not question the need for full disclosure to counterparties. This may be particularly important for entities that are not routine users of the futures and OTC swaps markets. However, APGA's members are not such entities and routinely enter into OTC transactions and have done so for many years. Accordingly, we suggest that the timing and extent of disclosure should be tailored in light of the relative sophistication of the parties and that the disclosure for standardized swaps be given in a specified form of disclosure.

For standardized swaps, we believe it should be sufficient for the swap dealer or MSP to provide a form disclosure at the outset of its relationship with a counterparty. We further suggest that the form of disclosure be specified by the Commission as it has done for futures trading under Commission Rule 1.55.

With respect to bespoke swaps, we suggest that delivery of the disclosure immediately prior to entering the swap is "reasonably sufficient." If the Commission believes that a longer time is necessary, the Commission should provide certainty to market participants by specifying a particular amount of time that would be deemed "reasonably sufficient." We believe that both dealers and counterparties would benefit from greater specificity and that such specificity would assist both in understanding the rules that govern their relationship.

D. Swap Dealers Acting as Advisors to Special Entities

Pursuant to its mandate under Dodd-Frank, the Commission has proposed rules that would impose significant new requirements on swap dealers that act as advisors to special entities. While we appreciate that Dodd-Frank requires enhanced disclosure to special entities, we believe that greater clarity in the regulations will avoid any unintended consequences, such as a possible reduction in market information being made available to special entities.

1. ***Proposed Rule 23.440(a)***

Proposed Rule 23.440(a) would specify that a swap dealer acts as an advisor to a special entity whenever it recommends a swap or trading strategy involving swaps to the special entity. The proposed rule specifies that a swap dealer would not be acting as an advisor merely by

[4] Proposing Release at 80643.

providing to a special entity information that is "general transaction, financial, or market information," or swap terms in response to a request for a competitive bid.[5]

Swap dealers regularly offer to provide APGA members with presentations or to participate in informational telephone conferences. They may offer information concerning new products or services being offered by the swap dealer or new market strategies. Making such a presentation, without advancing a particular course of action to the special entity, should not be considered advice, and we hope the Commission will make clear that a swap dealer making such a presentation or participating in such a telephone conference is not acting as an advisor.

APGA is concerned that without such clarity in the applicable standard, communications between APGA's members and swap dealers or MSPs that currently occur and are of great value may be chilled. APGA's members are generally very sophisticated users and traders of energy derivatives. They interact on an ongoing basis with swap dealers and MSPs, and in the course of such interactions may receive valuable information about the energy markets, particular products trading in those markets, market trends and market strategies. This exchange of information is often in the nature of what is frequently termed "market color," but many swap dealers are also very familiar with the hedge positions and market strategies of their APGA member counterparty. Accordingly, these swap dealers provide valuable information regarding hedging products that might fit with such positions and strategies.

We are concerned that any ambiguity in the definition of what constitutes acting as an advisor to a special entity will inhibit swap dealers' communications with special entities. As noted, the proposed rule defines "recommendation" to include "any communication by which a swap dealer or major swap participant provides information to a counterparty about a particular swap or trading strategy that is tailored to the needs or characteristics of the counterparty, but would not include information that is general transaction, financial, or market information, swap terms in response to a competitive bid request from the counterparty."[6] However, because a swap dealer, by virtue of a pre-existing relationship or because of general knowledge of the special entity's goals, objectives, and risk exposure, is familiar with the hedge positions and market strategy of a special entity, will likely be reluctant to provide the type of market information that is most useful to APGA market participants. To avoid the possibility of being deemed to have made a "recommendation," and therefore the need to comply with the substantial requirements of proposed Rule 23.440, swap dealers likely will greatly curtail their communications with APGA members if the proposed definition is adopted. Loss of this flow of information would be significant and could result in less transparency and reduced information for APGA members, a result that is not in the interest of the market, the dealers, APGA's members or their customers.

As an alternative to the current language, the Commission should clarify in the final rules that a "recommendation" which would trigger the advisor obligations should mean a firm indication by the swap dealer of a particular preferred transaction, swap, or market strategy, and should specify that the advisor obligations are triggered only when such a recommendation is the primary basis for the special entity's decision to take or refrain from taking a particular action.

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5 Proposed Rule 23.440(a).

6 Proposing Release at 80647.

The definition should make clear that a proposal offered for consideration is not a recommendation. Providing market color to a special entity or alerting a special entity to a possible strategy or action it might take or to new or refined products or services that are being offered, even when based upon knowledge of the special entity's hedge positions or market strategy, should not constitute making a recommendation that causes a swap dealer to be deemed to be an advisor to a special entity.

Defining "recommendation" in this way is quite reasonable in light of the requirement that special entities must be represented by independent representatives.[7] The use of an independent representative, which must be capable of understanding and evaluating the swap transactions that they review on behalf of, and ultimately may recommend to, the special entity, substantially reduces the risk that there will be any misunderstanding of the role in which a swap dealer is acting when it discusses possible transactions with the special entity.

2. ***Proposed Rule 23.440(b)-(c)***

Under proposed Rule 23.440(b), a swap dealer acting as an advisor to a special entity will be required to make reasonable efforts to obtain a wide range of information to determine that a recommended transaction or strategy is in the best interests of the special entity. The proposed rule would allow a swap dealer to rely on a special entity's representations with respect to the required information if there is a reasonable basis to believe the representations are reliable in the context of a particular transaction. The special entity's representations must also be sufficiently detailed to allow the swap dealer to reasonably conclude that the special entity is capable of independently evaluating the risks of the recommended transaction, exercising independent judgment, and absorbing potential losses associated with the transaction.

While we appreciate that proposed Rule 23.402(e) permits special entities to make the required representations as part of a master agreement, we believe that greater clarity with respect to what constitutes "a reasonable basis to believe that the representations are reliable" would benefit the relationship between swap dealers and special entities. This could be accomplished by providing that the representations made on behalf of a special entity by an authorized employee of the special entity or its independent representative will be conclusive unless the swap dealer has actual knowledge that such representations are untrue.

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[7] See Proposed Rule 23.450(b).

E. Independent Representative Requirement

1. ***Proposed Rule 23.450(b):***

Proposed Rule 23.450(b) requires swap dealers that offer or enter into swaps with special entities to "have a reasonable basis to believe that the Special Entity has a representative that" meets a list of qualifications. While we appreciate that proposed Rule 23.402(e) would allow independent representatives to special entities to make these representations as part of a master agreement, we believe the Commission should clarify that the representations need only be updated in the event of either a material change in one of the representations, or a change in the special entity's representative.

We are also concerned that there is some ambiguity about what will constitute a "reasonable basis" for swap dealers to rely on the representations of a special entity or its independent representatives. We request that the Commission clarify that written representations made (in the master agreement or otherwise) by a special entity or its independent representative will be conclusive unless the swap dealer has actual knowledge that such representations are untrue.

Moreover, the representations required by proposed Rule 23.450(b) should be tailored for special entities that, like many APGA members, have independent representatives that are their employees. For example, an independent representative that is an employee of the special entity should be presumed to have a duty to act in the special entity's best interests. Additionally, with respect to the requirement that a special entity's independent representative evaluate the fair pricing and appropriateness of a swap, the Commission stated in the Proposing Release that, absent red flags, swap dealers will be able to rely on appropriate legal relationships between the special entity and its representative, such as a contractual relationship between a pension plan and a fiduciary to whom it grants trading discretion. We request that the Commission clarify that swap dealers could also rely on the legal relationship between a special entity and its representative if the representative is an employee of the special entity.

The Proposing Release notes that independent representatives should document decisions about the appropriateness of pricing of all swap transactions.[8] We request that the Commission clarify that this requirement can be met by the implementation by the special entity of a hedge policy and periodic review by the special entity to ensure that its employees are acting in compliance with the policy.

Finally, proposed Rule 23.450(b) requires that a special entity's independent representative provide appropriate and timely disclosures to the special entity. We request that the Commission clarify the nature and subject matter contemplated by the "appropriate and timely disclosures" that will be required. We also believe that a special entity's representatives should be required to make such disclosures only at the outset of the relationship with the special entity and to update such disclosures in the event of a material change.

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[8] Proposing Release at 80653.

2. ***Proposed Rule 23.450(d)***

Proposed Rule 23.450(d) states that a swap dealer may rely on the representations of a special entity to satisfy its obligations under Rule 23.450(b) if (1) the swap dealer has a reasonable basis to believe that the representations are reliable, taking into account the circumstances of the representative-special entity relationship and in the context of a particular transaction; and (2) the representations have sufficiently detailed information for the swap dealer to assess the representative's qualifications in several respects.

APGA suggests that the Commission clarify the frequency with which special entities would be required to make representations to swap dealers regarding their independent representatives in order for swap dealers to rely on the representations. We believe it should be sufficient for swap dealers to rely on representations of a special entity made once with respect to each of the special entity's independent representatives, rather than in the context of each separate transaction.

We also believe that, when the independent representative of a special entity is an employee of the special entity, it should be sufficient for purposes of the representations required by Rule 23.450(b)(1)-(b)(6), for the special entity to represent that (1) it has a hedging policy; (2) the employee independent representative is subject to the policy; and (3) the special entity has a system in place to monitor compliance with the policy.

F. Disclosure of Swap Dealer Capacity

As required by Dodd-Frank, the Commission proposes, in proposed Rule 23.450(f), to require swap dealers to disclose to special entities "[b]efore the initiation of a swap" the capacity in which the swap dealer is acting. If the swap dealer is acting in more than one capacity, it must also disclose the material differences between such capacities.

We request that the Commission clarify what constitutes "before the initiation of a swap" for purposes of proposed Rule 23.450(f). It should be sufficient for swap dealers to state the capacity in which they intend to act in their master agreement with a special entity. Additional disclosures should be required only in the event that the swap dealer intends to act in a capacity that differs from the representation in the master agreement.

Conclusion

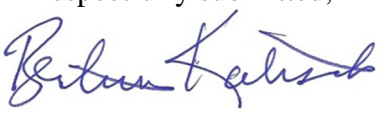
As APGA has noted in the past, natural gas is a lifeblood of our economy and millions of consumers depend on natural gas every day to meet their needs. It is critical that the price that those consumers pay for natural gas comes about through the operation of fair and orderly markets and through appropriate market mechanisms that establish a fair and transparent marketplace. For this reason, APGA members strongly support the Commission's initiatives that are intended to reduce risk, increase transparency, and promote market integrity within the financial system by addressing the swaps market.

Our comments are grounded in the concern that certain aspects of the proposed rules may actually have the unintended consequence of either discouraging swap dealers or MSPs from acting as counterparties to special entities, or do so only on terms that will reduce the utility of

the markets for our members or disadvantage our members in using these markets when compared to similar, investor-owned utilities. Our suggested modifications and clarifications would preserve our members' ability to make use of the OTC swaps markets efficiently. We believe that such a result will achieve Congress' intent, benefit the markets and, most importantly, benefit the consumers that our members serve.

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