UNITED STATES OF AMERICA
BEFORE THE
COMMODITY FUTURES TRADING COMMISSION

Aggregation, Position Limits for Futures and Swaps) RIN 3038-AD82

COMMENTS OF THE AMERICAN GAS ASSOCIATION

Pursuant to the Notice of Proposed Rulemaking issued May 30, 2012,[1] by the Commodity Futures Trading Commission ("CFTC" or "Commission"), the American Gas Association ("AGA") respectfully submits these comments. AGA commends the Commission for providing more workable position limits rules by expanding the aggregation exemption in response to AGA's and other industry stakeholders' concerns.[2] AGA respectfully recommends that the Commission eliminate the bright-line fifty-percent ownership limit and permit persons with any ownership or equity interest in excess of ten percent to demonstrate a lack of effective control over the owned entity. AGA also recommends that the Commission permit the sharing of lawyers, accountants, risk managers, compliance officers and other personnel that are not involved in the day-to-day activities of trading among persons and their owned entities, notwithstanding the fact that such employees may have some knowledge of the entities' trading decisions. AGA supports the extension of the information-sharing exemption from aggregation of accounts to include circumstances where entities face a reasonable risk of violating state laws, as well as rules and regulations imposed by a state commission or other regulatory authority with

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[1] *Aggregation, Position Limits for Futures and Swaps*, 77 Fed. Reg. 31,767 (May 30, 2012) ("Notice").

[2] *See AGA Comment Letter on Interim Final Rule Regarding Position Limits for Futures and Swaps* RIN 3038-AD17 (Jan. 17, 2012); *Joint EEI-AGA Petition for Order to Exempt Owned Non-Financial Entities from Aggregation for Compliance with Position Limits and Order to Broaden and Clarify Rule 151.7(i)* (March 1, 2012).

jurisdiction. Further, AGA advocates that such exemption should not be limited solely to state laws that parallel federal law, but should apply for all laws, rules, regulations and orders regardless of whether they have parallels in federal law.

I. COMMUNICATIONS

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

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II. IDENTITY AND INTERESTS

The AGA, founded in 1918, represents more than 200 local energy companies committed to the safe delivery of clean natural gas to more than 65 million customers throughout the United States. There are more than 70 million residential, commercial and industrial natural gas customers in the United States, 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's members engage in financial risk management transactions in markets regulated by the Commission. 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

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

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, in particular volatility in natural gas commodity costs. As such, AGA's members will be directly affected by the Commission's final regulations governing position limits for futures and swaps.

III. COMMENTS

In a final rule published on November 18, 2011,[4] the Commission set forth its position limits regime, which generally provides that unless a particular exemption applies, a person must aggregate all positions for which that person controls the trading decisions with all the positions for which the person has a ten percent or greater ownership interest in an account or position.[5] In the Notice, the Commission proposed to extend the exemption from aggregation under section 151.7(i) for instances where there is a reasonable risk of violation of federal law to include reasonable risks of violation of state, local and foreign laws.[6] The Commission also proposed to provide a procedure under which a person with a ten percent or greater ownership interest could disaggregate the positions of a separately organized entity upon a sufficient demonstration of independence.[7] However, under the Commission's proposal the ability to rebut the presumption of control and establish independence would not be available to persons with an ownership interest greater than fifty percent.[8]

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[4] *Position Limits for Futures and Swaps*, 76 Fed. Reg. 71,626 (Nov. 18, 2011).
[5] *See* 17 C.F.R. § 151.7(a) & (b).
[6] 77 Fed. Reg. at pp. 31,771-72.
[7] *Id.* at pp. 31,772-75.
[8] *Id.*

AGA believes that the Commission's rulemakings to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[9] should ensure that 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. AGA supports the Commission's use of position limits regulations to reduce systemic risk, increase market transparency and promote market integrity within the financial system. AGA believes that the proposals to expand aggregation exemptions related to information-sharing restrictions, to expand circumstances under which market participants will not be required to aggregate positions, and to reduce reporting burdens on higher tier entities are steps in the right direction. However, AGA urges the Commission to make further modifications to Part 151 of the Commission's regulations that are consistent with the Commission's goals but that do not hinder the commercial risk management functions undertaken by gas utilities on their customers' behalf. To that end, AGA offers the following comments addressing the Commission's inquiries in the Notice regarding the feasibility, necessity and practicability of the proposed requirements.

A. The Commission Should Modify The Proposed Owned-Entity Exemption From Aggregation To Eliminate The Fifty-Percent Threshold.

The Commission's proposal in the Notice provides that persons with an ownership or equity interest in an entity (financial or non-financial) of less than ten percent need not aggregate the accounts or positions of the owned entity with any other accounts or positions. If the ownership interest is between ten and fifty percent, the person must aggregate positions with those of the owned entity unless it can be shown that there is a lack of control over the trading

[9] Pub. L. No. 111-203 (July 21, 2010).

decisions of the owned entity based on five indicia demonstrating independence.[10] Under the Commission's proposal, such person may not disaggregate positions if they have greater than a fifty percent ownership or equity interest in the owned entity, regardless of the level of independence of the trading decisions of the owned entity.[11] In other words, the Commission's proposal mandates aggregation in all cases where the person's ownership or equity interest in the owned entity is greater than fifty percent, regardless of whether the person has knowledge of, or control over, the trading decisions of the owned entity. The Commission explained that the fifty-percent limit would provide administrative certainty, and that to the extent the majority owner may have the ability and incentive to direct, control or influence the management of the owned entity, the proposed bright-line test would be a reasonable approach to the aggregation of owned accounts.[12]

The Commission should take a closer look at how the central concept of control should be included in the aggregation exemption. AGA believes that a person that does not have knowledge or control over the trading decisions of the owned entity should not be required to aggregate its positions regardless of the percentage of ownership or equity interest. If a person has no knowledge or control over the trading decisions of an owned entity, there is no increased risk from allowing those two entities to disaggregate their positions. By allowing persons with an up to fifty-percent ownership or equity interest in an owned entity to rebut the presumption of control but deny such relief to persons with greater than fifty percent interests is to draw an arbitrary line at fifty percent, irrespective of risk. AGA recognizes that a majority interest may, as the Commission has expressed, provide an opportunity for direct or indirect influence over the

[10] *See proposed* § 151.7(b)(1)(i)(A) through (E).
[11] *See proposed* § 151.7(b)(1)(ii).
[12] 77 Fed. Reg. at p. 31,774.

trading of the owned entity.[13] However, if the person can demonstrate that it lacks actual control, it *perforce* has mitigated or eliminated any such risk of influence. In those circumstances, no regulatory purpose would be served by requiring such person to aggregate its positions with those of the owned entity, regardless of the level of ownership.

In many cases, moreover, the ownership interest is indirect in that a person may be a subsidiary of a parent or holding company that also owns one or more other entities that engage in hedging transactions or financial trading. Indeed, while some or all of the lower-tier companies may engage in hedging or trading, the higher-tier company, which is the source of the common ownership, may not engage in any such trading activities at all. If the individual, lower-tier companies have entirely independent trading operations, the common ownership – even 100 percent ownership – by the higher-tier entity would present no risk of influence and should not provide a basis to require the aggregation of positions.

AGA agrees that the Commission's aggregation rules should provide a clear method to determine which persons or entities may have the ability to control the trading decisions of their lower-tier or affiliated entities in a manner that could result in coordinated trading or market manipulating activity. AGA contends, however, that ownership, even majority ownership, should not be used as a placeholder for actual indicia of control. AGA recommends, therefore, that the only bright-line test based on ownership should be the ten percent threshold, above which persons must either aggregate the positions of an owned entity or make an affirmative demonstration that the person lacks actual control over the trading decisions of the owned entity. This formulation would permit persons with any passive ownership interest in excess of ten percent to demonstrate a lack of effective control over the owned entity.

[13] *See id.* at p. 31,775.

AGA believes that such approach would relieve the Commission of the administrative complexity of pre-determining what ownership structures do and do not present a risk of market-manipulating control among affiliated entities. Moreover, such approach would address industry concerns regarding the arbitrariness of the fifty-percent limit and allow a person to demonstrate the circumstances under which ownership does not translate into common control or actual knowledge over trading decisions across affiliated entities. Further, AGA believes that this approach would give the Commission the necessary information and appropriate segue to adopt a broader passive investment exemption that accommodates instances in which beneficial ownership in several otherwise unrelated accounts may be greater than ten percent but does not provide the owner(s) any control over those positions.

B. The Commission Should Clarify That Persons May Share Employees With Owned Entities And Remain Eligible For Disaggregation.

Under the Commission's proposal, in order to demonstrate a lack of control over the trading decisions of an owned entity, a person must show that both the person and the owned entity: (i) do not have knowledge of the trading decisions of the other; (ii) trade pursuant to separately developed and independent trading systems; (iii) have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about, the trades of the other; (iv) do not share employees that control the trading decisions of either; and (v) do not have risk management systems that permit the sharing of trades or trading strategy.[14] In the Notice, the Commission sought comment on whether the sharing of employees would compromise independence because it would provide each entity with knowledge of the other's trading decisions.[15]

[14] *See* proposed § 151.7(b)(1)(i)(A) through (E).
[15] 77 Fed. Reg. at p. 31,774.

AGA believes that shared employees not involved in the day-to-day trading activities of an entity present no risk of undermining independence, even if they may have some knowledge of another entity's trading decisions, as long as those employees do not serve as a conduit for sharing knowledge of trading information among affiliates. AGA recommends that the Commission look to the standards of conduct promulgated by the Federal Energy Regulatory Commission ("FERC") in considering when employees may be shared among entities and their affiliates.[16] In general, FERC's standards of conduct require jurisdictional electric utilities and interstate natural gas pipelines to ensure that their transmission employees function independently from their marketing or wholesale merchant function employees or those of their affiliates.[17] Under FERC's standard of conduct, jurisdictional entities may share support employees, senior officers and directors, risk management employees, and lawyers, etc., provided such employees do not act as a conduit for the sharing of confidential or prohibited information.[18] FERC explained, for example that shared lawyers may participate in business decisions by rendering legal or regulatory advice in their traditional roles as long as they are not involved in planning, directing, organizing, or otherwise being directly involved in transmission functions.[19] In other words, a lawyer acting in his or her traditional role and not involved in the

[16] *Standards of Conduct for Transmission Providers*, Order No. 2004, FERC Stats. & Regs., Reg. Preambles ¶ 31,155 (2003), *order on reh'g*, Order No. 2004-A, FERC Stats. & Regs., Regs. Preambles ¶ 31,161 (2004), *order on reh'g*, Order No. 2004-B, 108 FERC ¶ 61,118 (2004), *order on reh'g*, Order No. 2004-C, 109 FERC ¶ 61,325 (2004), *order on reh'g*, Order No. 2004-D, 110 FERC ¶ 61,320 (2005), *vacated and remanded as applied to natural gas pipelines sub nom. National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006); *Standards of Conduct for Transmission Providers*, Order No. 690, 72 Fed. Reg. 2,427 (Jan. 19, 2007), FERC Stats. & Regs., Regs. Preambles ¶ 31,237 (2007), *order on clarification and reh'g*, Order No. 690-A, 72 Fed. Reg. 14,235 (Mar. 27, 2007), FERC Stats. & Regs., Regs. Preambles ¶ 31,243 (2007).
[17] *See* 18 C.F.R. Part 358.
[18] *See* 18 C.F.R. § 358.6.
[19] Order No. 690 at P 24-25 (citing Order No. 2004-B at P 74).

day-to-day activities of the transmission function presents such little risk of engaging in prohibited conduct that prohibiting the sharing of such employee would be unjustified.

AGA, therefore, recommends that the Commission permit the sharing of lawyers, accountants, risk managers, compliance officers, and other personnel that are not involved in the day-to-day activities of trading among persons and their owned entities, notwithstanding the fact that such employees may have some knowledge of the entities' trading decisions. Such employees performing their traditional roles present little risk that they would be able to use such information to compromise the independence of each entity' trading activities.

C. The Commission Should Provide For An Exemption Based on State Law.

In the Notice, the Commission proposed to clarify the scope of the exemption to include circumstances where the sharing of information required to aggregate positions would create a reasonable risk of violation of federal law.[20] The Commission also proposed to extend this information sharing exemption to entities seeking relief based on a reasonable risk of violation of state law or regulations adopted thereunder.[21] The Commission sought comment on whether it should extend the exemption or alternatively adopt a case-by-case approach to granting exemptions under the petition process of Section 4a(a)(7) of the Commodity Exchange Act.[22] The Commission also inquired whether the proposed state law exemption should be limited to those laws that have a comparable provision at the federal level.[23]

AGA supports the extension of the information-sharing exemption from aggregation of accounts to include circumstances where entities face a reasonable risk of violating state laws, as well as rules and regulations imposed by a state commission or other regulatory authority with

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[20] 77 Fed. Reg. at p. 31,771.
[21] *Id.* at p. 31,772.
[22] *Id.*
[23] *Id.*

jurisdiction. In many instances, such regulations prohibit a regulated utility from sharing information or profits, or coordinating operations with, affiliates or business units that are not regulated by the state commission. The purpose of these rules is to ensure that the regulated utility's customers do not bear the cost risks associated with the unregulated entity's activities. For some utilities, energy trading and financial hedging transactions are types of activities that are required to be kept separate.

For example, Texas law broadly prohibits electric utilities in the state of Texas from allowing unregulated affiliates from obtaining a utility's confidential information.[24] If a utility that owns an affiliated marketing company were forced to aggregate the swap positions of the utility and the marketing company for the purposes of reporting to the CFTC, the affiliated marketing company could gain non-public information relating to the utility's swap positions. The affiliated marketing company would know, based on its own swap positions, that at the very least, its affiliated utility's swap positions were above a certain threshold. Other marketers would not be able to make that determination because they would not be privy to the affiliated marketer's own swap positions. This could confer a competitive advantage on the affiliated marketer, which is precisely what Texas is trying to prevent.

Most states have similar mechanisms to prevent a non-utility affiliate from gaining a competitive advantage in its dealings with a regulated utility. The commonwealth of Kentucky requires that, "[a]ll utility company employees engaged in the merchant function shall abide by all standards promulgated by applicable FERC orders and regulations."[25] As previously discussed, FERC's standards of conduct prohibit the sharing of confidential (non-public) information. Requiring affiliates to aggregate their swap positions would undermine the

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[24] 16 Tex. Admin. Code § 25.272.
[25] Ky. Rev. Stat. § 278.2213 (2011).

significant lengths that FERC and states have gone to prevent regulated and non-regulated entities from having common control and/or sharing non-public information. For this reason, the aggregation requirements should focus on common control rather than on common ownership.

AGA recognizes that the Commission remains concerned about the potential for evasion within the context of this exemption, particularly when the asserted regulatory impediment to the sharing of information arises from foreign, state, or local laws and/or regulations that the Commission does not directly administer.[26] However, AGA believes that a case-by-case petition approach would be administratively burdensome, and that the Commission has the requisite tools to procure any and all of the information it seeks from applicants through the notice and opinion of counsel filing requirements under the Commission's proposal.[27] Gas utilities with corporate structures and operations that are split among state-regulated and independent market divisions within and across state lines should be able to present the Commission with a single, complete picture of the extent to which their affiliates are precluded from sharing information under a variety of restrictions established by state law or imposed in regulations by their state commission(s).

Moreover, AGA does not believe that the extension of the information-sharing exemption based on state law should be limited to state laws that have a parallel in federal law. As noted above, many of the state laws and regulations that prohibit information and cost sharing among affiliates do so to prevent the regulated utility's customers from bearing the cost risks associated with the unregulated affiliate's activities. Although FERC has developed standards of conduct and codes of conduct that govern conduct among affiliates, the purposes and requirements are not the same. Accordingly, AGA contends that the Commission should permit entities to make a

[26] *See* 77 Fed. Reg. at p. 31,771.
[27] *See* proposed §§ 151.7(h) and (i).

showing, through the requisite opinion of counsel, that aggregation would present a reasonable risk of violation of state law or state regulations, regardless of whether there is a parallel federal law.

IV. CONCLUSION

Wherefore, for the reasons stated above, the American Gas Association respectfully recommends that the Commission eliminate the bright-line fifty-percent ownership limit and permit persons with any ownership or equity interest in excess of ten percent to demonstrate a lack of effective control over the owned entity. AGA also recommends that the Commission permit the sharing of lawyers, accountants, risk managers, compliance officers, and other personnel that are not involved in the day-to-day activities of trading among persons and their owned entities, notwithstanding the fact that such employees may have some knowledge of the entities' trading decisions. Further, AGA supports the extension of the information-sharing exemption from aggregation of accounts to include circumstances where entities face a reasonable risk of violating state laws, as well as rules and regulations imposed by a state commission or other regulatory authority with jurisdiction, and that such exemption should not be limited to state laws that have a parallel in federal law.

Respectfully Submitted,

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