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October 12, 2012

Sauntia Warfield
Assistant Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 *Fed. Reg. 48,208* (August 13, 2012); RIN 3235-AK65, SEC File No. S7-16-11; Petition for Interpretative Statement.

Dear Ms. Warfield:

We are submitting these comments on behalf of our clients, ONEOK, Inc. and ONEOK Partners, L.P. ("ONEOK Partners") (collectively "ONEOK"). We appreciate the opportunity to submit our views to the Commodity Futures Trading Commission ("CFTC" or "Commission") on the joint final rule (and request for comments) entitled, "Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement Recordkeeping," 77 *Fed. Reg. 48,208* (August 13, 2012) ("Final Rulemaking").[1]

ONEOK urges the Commission to clarify, through the issuance of an Interpretative Statement, that agreements for the transportation and storage of natural gas that are priced using a two-part rate, consisting of a monthly reservation or demand charge and a separate usage charge, fall within the exclusion from the definition of "swap" under section 1a(47)(B)(ii) of the Commodity Exchange Act, 7 U.S.C. §1 *et seq* ("Act") for the sale of a nonfinancial commodity for deferred shipment or delivery which is intended to be physically settled ("forward contract exclusion"). Such pricing conventions have been long standing, routine and accepted forms of payment for the delivery of natural gas in normal cash market channels.

[1] ONEOK, Inc., and ONEOK Partners are members of the American Gas Association, the Texas Pipeline Association, and the Interstate Natural Gas Association of America. ONEOK supports the comments submitted separately by those associations.

Description of ONEOK

ONEOK, Inc. is a diversified energy company that has three business units: Natural Gas Distribution, Energy Services, and ONEOK Partners, L.P.

ONEOK, Inc.'s Natural Gas Distribution segment is comprised of three natural gas local distribution companies ("LDCs") that serve over two million customers in Oklahoma, Kansas and Texas.

ONEOK Inc.'s Energy Services business is engaged in providing premium natural gas wholesale marketing services to its customers across the United States. These services are provided by ONEOK Energy Services Company, L.P. ("OES"), a wholly-owned subsidiary of ONEOK. OES engages in the physical marketing and delivery of natural gas and bundled services throughout the United States and Canada.

ONEOK, Inc. is the sole general partner and owns 43.4% of ONEOK Partners. ONEOK Partners is a publicly traded master limited partnership that is engaged in natural gas gathering and processing, natural gas pipelines and storage, and natural gas liquids.

Transportation and Storage Agreements with Two-Part Rates Should Not be Considered Options

In the Final Rule, the Commission provided an interpretation regarding natural gas pipeline transportation and storage agreements[2] and concluded that such agreements would not be considered options, and therefore would not be regulated as swaps, if they satisfied a three-part test: (1) the subject of the agreement is usage of a specified facility, or part thereof, rather than the purchase or sale of the commodity that is to be transported or stored using the facility; (2) the agreement grants the buyer the exclusive use of the facility, or part thereof, during its term, and places an unconditional obligation on the seller to grant such exclusive use; and (3) the payment represents a payment for use of the facility rather than the option to use it.[3] The Commission then added:

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[2] Although the Final Rule referred only to natural gas transportation and storage agreements, in ONEOK's view the interpretative guidance would not necessarily be limited to natural gas. For example, in addition to its natural gas pipeline and storage companies, ONEOK Partners also has a substantial natural gas liquids ("NGL") business, which regularly enters into commercial agreements for transportation and storage on its facilities. To the extent any of these NGL agreements meet the criteria set forth in the Commission's regulations or interpretive guidance, they would be impacted in the same manner as natural gas agreements. Accordingly, ONEOK requests that the Commission consider the impact of its interpretive guidance on, not only natural gas contracts, but on NGL agreements as well.

[3] 77 *Fed. Reg.* at 48,242.

> However, in the alternative, if the right to use the specified facility is only obtained via the payment of a demand charge or reservation fee, and the exercise of the right (or use of the specified facility or part thereof) entails the further payment of actual storage fees, usage fees, rents, or other analogous service charges not included in the demand or reservation fee, such agreement, contract or transaction is a commodity option subject to the swap definition.[4]

ONEOK previously submitted comments responsive to the Commission's Notice of Proposed Rulemaking ("Proposed Rulemaking") regarding the definition of a "swap."[5] In its comment, ONEOK described the utilization and value of natural gas forward contracts with embedded volumetric optionality and urged the Commission to clarify that such contracts fall within the contract forward exclusion of section 1a(47)(B) of the Act. However, the Commission, in its Proposed Rulemaking, neither discussed, nor requested comment on, transportation and storage agreements with two-part rates and gave no indication that it was proposing that such routine delivery contracts might fall within the proposed definition of "swap." The Commission's interpretation with respect to commercial agreements with two-part rates appeared for the first time in the Final Rulemaking. This is a critically important issue to both ONEOK and the energy industry as a whole. ONEOK respectfully petitions the Commission to accept this letter as part of the Final Rulemaking record, and to clarify through a subsequent Interpretative Statement that two-part rate agreements, which are merely an alternative rate structure for contracts intended to result in delivery, are within the forward contract exclusion.

Natural gas transportation and storage agreements are intended by the parties thereto to result in physical settlement of the contract. Contracts for firm service commonly employ a rate that consists of a monthly reservation or demand charge, which is to reserve a defined amount of space on the pipeline, and a separate usage charge that applies when gas flows. This two-part rate structure is a traditional method of establishing rates for firm transportation and storage service. The Federal Energy Regulatory Commission ("FERC") requires interstate natural gas pipelines to use this type of rate structure, and it is also a rate recovery mechanism reviewed and approved by state regulatory agencies with respect to the intrastate rates that they regulate. This commonly used rate structure is typically designed in order to recover all or most of the facility's fixed costs through the monthly demand charge, and the variable costs associated with providing service to the customer through the usage fee. The parties in a two-part rate agreement enter into such an agreement with the intent to deliver under the contract. The intent of the two-part cost structure is not to establish an optional pricing arrangement, but rather to apportion the fixed and variable costs associated with the facility's actual delivery of a physical commodity. As

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[4] *Id.*

[5] *See* ONEOK letter of July 22, 2011, in response to Notice of Proposed Rulemaking, 76 Fed. Reg. 29,818 (May 23, 2012), attached hereto.

mentioned above, this rate structure is often required by the regulators of these facilities or services.

Market participants contracting for transportation and storage services do so to provide for the movement or storage of gas with the expectation that delivery will occur through performance on the contract. These commercial agreements satisfy the critical element of the forward contract exclusion in that they are unquestionably intended by the parties to be settled physically. Therefore, the analysis for classifying delivery agreements using a two-part rate structure should be no different than that used for forward contracts or, if applicable, forward contracts with embedded volumetric optionality.[6] Such transportation and storage agreements are inextricably tied to the physical delivery of natural gas, whether or not the rate for these services is structured to apportion separately fixed and variable costs.

Regulating Transportation and Storage Agreements as Swaps Would Create an Undue Burden, with Little or no Benefit Derived from such Regulation

A determination that contracts for transportation or storage of a physical commodity with two-part rates are options would have a significant adverse impact upon ONEOK and would be unduly burdensome. Moreover, such contracts do not pose the type of systemic risk to the U.S. financial markets intended to be addressed by the Dodd Frank Act and its regulation of swap transactions. The Commission's interpretation with regard to two-part rates constitutes an undue and unjustified burden which the Commission failed to take into account in its assessment of the costs and benefits of these rules.

ONEOK and ONEOK Partners collectively have more than 9,000 two-part rate transportation and storage agreements in place, either as the provider of the services or the recipient thereof (and in the case of the LDCs, as both the provider and the recipient). For example, as earlier described, ONEOK, Inc. has three natural gas LDCs - Kansas Gas Service Company ("KGS"), Oklahoma Natural Gas Company ("ONG"), and Texas Gas Service Company ("TGS"). Each LDC provides unbundled transportation service[7] to thousands of their

[6] ONEOK has some concerns about the seventh factor of the test enunciated by the Commission for determining whether a particular transaction with an embedded volumetric option is excluded from regulation, which is that the exercise or non-exercise of the optionality is based primarily on physical factors or regulatory requirements that are outside the control of the parties and are influencing demand for, or supply of, the nonfinancial commodity. Natural gas consumers, particularly LDCs, must take into account a variety of factors in determining which assets in their energy portfolio to exercise on any given day. In this regard, ONEOK supports the comments filed by the American Gas Association on this issue.

[7] Historically, utilities provided a "bundled" service consisting of both the natural gas supply and the distribution (or transportation) of the gas to the end-use customer. In recent years, however, FERC and state regulatory agencies have authorized (and in some cases mandated) LDCs and pipelines to "unbundle" those services and make them separately available, such that larger customers are able to procure their own gas supplies, which the LDC or pipeline then just transports for the customer.

larger commercial and industrial customers, and that service is provided pursuant to tariffs with two-part rates that have been approved by their respective state regulatory agencies. The number of commercial agreements in this category, all of which are potentially subject to regulation as options, is exceedingly large: KGS currently has approximately 3,200 agreements to provide unbundled transportation service to its utility customers, ONG has nearly 5,300, and TGS has slightly more than 400.[8] The term of the contracts vary.

In addition to the ONEOK, Inc. entities, several ONEOK Partners entities similarly will be adversely impacted by the broad reach of the Commission's regulation of commercial agreements. ONEOK Partners has four natural gas interstate pipelines, all of which are subject to FERC jurisdiction. Accordingly, pursuant to FERC directive, the pipelines' firm transportation rates are required to use the two-part rate methodology. Often these pipelines include "capacity release" contracts as well.[9] In addition, there are three intrastate pipeline company subsidiaries, each of which is subject to regulatory oversight in its respective state (Kansas, Oklahoma, and Texas), and three intrastate storage company subsidiaries, all of which utilize two-part rate structures for their firm service commercial contracts.

Finally, as noted earlier, ONEOK Partners also has a substantial NGL business, which enters into commercial agreements for transportation and storage on its facilities. The NGL pipeline companies are subject to various levels of regulation by FERC and the states in which they are located. The NGL commercial agreements vary in structure, but are also potentially subject to the Commission's interpretation with respect to two-part rate agreement.

ONEOK recognizes that the Commission has established an exemption for trade options[10] and that these agreements, if determined not to be forward contracts, are likely to fall within the trade option exemption. However, this determination is still fraught with numerous issues and uncertainties, and does not address all of the issues raised by the Commission's Interpretation.

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[8] Taken to a logical next step, the "however" language in the interpretative guidance regarding two-part rates could be applied to an LDC's service to its residential and small commercial customers. This is because the tariffs under which those customers are served have a flat monthly customer charge that is assessed regardless of whether any gas is used during the month, and a per unit commodity charge when gas is delivered. This two-part rate structure clearly does not represent an option, but yet could be captured by the language in the interpretive guidance and thereby impact the nearly 2 million customers served by the ONEOK LDCs.

[9] Capacity release transactions often take place on interstate pipelines, including on a daily basis. Under FERC regulations, a firm shipper on an interstate pipeline (or storage facility) may release some or all of its transportation capacity to a replacement shipper. This is typically done when the original shipper does not need the capacity during a particular period, and is a way to recoup a portion of its monthly demand costs, which it must pay to the pipeline, whether the transportation service is used or not. The result is deemed to be a new contract between the replacement shipper and the pipeline. If it is under a two-part rate, it also would be subject to Commission regulation as an option. The release may be for a term as short as one day.

[10] "Commodity Options," 77 *Fed. Reg*, 25,320 (April 27, 2012).

The vast majority of the counterparties to these various firm transportation and storage contracts, particularly utility customers, are wholly unaware that their two-rate transportation or storage contracts may be swept up as an option and subject to various swap regulations, including the reporting of trade options.

Moreover, there is a lack of certainty that all of these contracts will qualify as trade options. It is possible that many entities technically may not qualify for the trade option exemption. In this regard, it should be noted that this common form of rate structure is used by natural gas LDCs throughout the country, including in the metropolitan Washington, D.C. area. Many Commission employees who enjoy natural gas service to their residences no doubt pay for that residential service under a two-part rate structure whereby they pay a fixed charge for system availability and a variable charge for the amount of natural gas consumed. The exemption under Commission Rule 32.3(a) (2) provides that to be exempt from most regulation as a swap, the offeree of the commodity option must be "a producer, processor, or commercial user of, or a merchant handling the commodity that is the subject of the commodity option."[11] It is unclear that a residential consumer qualifies for the trade option exemption in connection with these two-part rate agreements for delivery of natural gas. Although the Commission has made clear that consumer contracts "to purchase products or services for personal, family or household purposes at a fixed price or a capped or collared price, at a future date or over a certain time period (such as agreements to purchase for personal use or consumption nonfinancial energy commodities" are not swaps, two-part rate contracts are not mentioned as part of this relief. [12] Are these contracts to be considered "swaps"?

In summary, ONEOK submits that transportation and storage agreements with two-part rate structures are contracts intended for physical delivery of gas and merely provide for a rate structure to apportion fixed and variable costs to ratepayers. It is the intention of those entering into these contracts to make or take the transportation or storage services under these agreements. These contracts, unlike swaps, are not intended to be a financial contract separate from delivery of the contracted for services. They are forward contracts, under which the parties intend to move (or store) natural gas. Accordingly, ONEOK respectfully requests that the Commission clarify through an Interpretative Statement that these two-part rate natural gas storage and transportation agreements fall within the scope of the forward contract exclusion under section 1a(47)(B) of the Act.

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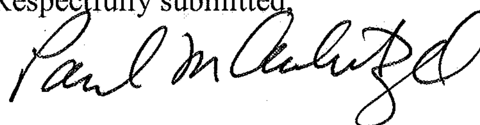
[11] *Id.*

[12] *See* "Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement Recordkeeping; Final Rule, 77 *Fed. Reg.* 48208, 48246 (August 13, 2012).

We would be happy to discuss our comments at greater length with the staff. If you have any questions regarding ONEOK's comments, please feel free to contact Vicky Hale, Vice President and Associate General Counsel, Compliance and Regulatory, ONEOK, Inc. at 918-588-7949, or Paul M. Architzel of Wilmer Cutler Pickering Hale and Dorr LLP, outside counsel to ONEOK, at (202) 663-6240.

Respectfully submitted,



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Cc: Chairman Gensler
Commissioner Chilton
Commissioner O'Malia
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Daniel Berkovitz, General Counsel