

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

Aggregation of Positions) RIN 3038-AD82

COMMENTS OF THE AMERICAN GAS ASSOCIATION

Pursuant to the Notice of Proposed Rulemaking (“Notice”) issued November 15, 2013,¹ by the Commodity Futures Trading Commission (“Commission”), the American Gas Association (“AGA”) respectfully submits these comments. AGA commends the Commission’s efforts to make the aggregation exemptions more practicable in response to AGA’s and other energy industry commenters’ concerns.² However, as described below, AGA urges the Commission to make certain additional modifications that AGA believes are consistent with the Commission’s goals but provide a meaningful opportunity for AGA members and other similar entities to obtain reasonable disaggregation relief.

I. COMMUNICATIONS

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

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¹ *Aggregation of Positions*, Notice of Proposed Rulemaking, 78 Fed. Reg. 68946 (Nov. 15, 2013).

² See AGA Comment Letter on Proposed Rule, Aggregation of Futures and Swaps (June 29, 2012); AGA Comment Letter on Interim Final Rule Regarding Position Limits for Futures and Swaps, RIN 3038-AD17 (Jan. 17, 2012); and 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).

II. IDENTITY AND INTERESTS

The American Gas Association, founded in 1918, represents more than 200 local energy companies that deliver clean natural gas throughout the United States. There are more than 71 million residential, commercial and industrial natural gas customers in the U.S., of which 92 percent — more than 65 million customers — receive their gas from AGA members. AGA is an advocate for natural gas utility companies and their customers and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international natural gas companies and industry associates. Today, natural gas meets almost one-fourth of the United States' energy needs. For more information, please visit www.aga.org.

AGA's members engage in financial risk management transactions in markets regulated by the Commission. AGA members 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 Commission-regulated exchanges and over-the-counter energy derivatives, to hedge the commercial risks associated with providing safe, reliable and cost-effective natural gas service to their customers. As such, AGA's members will be directly affected by the Commission's regulations governing aggregation of positions for futures and swaps.

III. COMMENTS

In the Notice, the Commission proposed procedures under which a person with an ownership interest in an entity of greater than 10 percent, but not more than 50 percent, can seek to disaggregate its trading positions from those of the owned entity, based on a sufficient

demonstration of independence.³ The Commission also proposed that a person with a greater than 50 percent interest in an owned entity can seek to disaggregate its trading positions from those of the entity if the person makes certain certifications to the Commission, in addition to a notice filing.⁴ However, the Commission retained discretion to grant relief irrespective of whether the person has satisfied some or all of the proposed conditions, and noted that certain additional factors, like the acquisition of a standalone business, may weigh in favor of granting relief.⁵ The Commission noted that persons unable to meet these proposed conditions would be able to file a petition for relief under Section 4a(a)(7) of the Commodity Exchange Act (“CEA”), and requested comment on whether the statutory relief process should be made available.⁶ The Commission stated that with respect to the notice filing required to demonstrate a lack of control between a person and an owned entity, the mere fact of sharing of employees, personnel and board members does not compromise independence.⁷

The Commission further proposed that a person need not aggregate its positions with those of an owned entity if the sharing of information associated with such aggregation creates a reasonable risk that either the person or entity could violate state or federal law, or regulations adopted thereunder.⁸

Subsequently, the Commission proposed rules to establish position limits for futures, options and economically equivalent physical commodity swaps in 28 exempt and agricultural commodities, generally requiring that unless a particular exemption applies, all positions in accounts for which any person directly or indirectly controls trading, or has a ten percent or

³ 78 Fed. Reg. at p. 68958.

⁴ *Id.* at p. at 68959.

⁵ *Id.* at p. 68960.

⁶ *Id.*

⁷ *Id.* at p. 68961.

⁸ *Id.* at p. 68950.

greater ownership interest, must be aggregated with the positions held and trading done by such person.⁹

AGA believes that the Commission's rulemakings to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") 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 commends the Commission for recognizing that in certain situations disaggregation relief may be warranted, even for majority owners, and thanks the Commission for seeking to revise its rules accordingly. AGA also commends the Commission's recognition that any number of additional factors may be favorable to granting relief under the over-fifty percent exemption process, and appreciates the Commission's inclusion of specific relief for higher-tier ownership entities. AGA believes that the Commission has provided workable criteria for the sharing of personnel and corporate leadership that may have some knowledge of trading activities but do not have any ability to control, participate or otherwise influence trading activities. AGA supports the Commission's expanded guidance permitting disaggregation due to a risk of violating information-sharing restrictions in state law, as well as the Commission's specific guidance that clarifies and simplifies parameters for the legal memorandum requirement.

However, AGA urges the Commission to make further modifications to the proposed aggregation rules that are consistent with the Commission's goals but provide a meaningful

⁹ *Position Limits for Derivatives*, Notice of Proposed Rulemaking, 78 Fed. Reg. 75680 (Dec. 12, 2013).

opportunity for gas utilities to use the processes that the Commission has proposed for seeking disaggregation relief. AGA offers the following comments addressing the Commission's inquiries in the Notice regarding the practicability of the proposed requirements and additional information that the Commission should consider as favorable to requests for disaggregation relief.

A. The Commission Should Permit Majority Owners To Demonstrate A Lack Of Control Irrespective Of Financial Statement Consolidation Requirements.

Among the several conditions discussed as prerequisites to disaggregation relief, the Commission proposed that a person with a greater than 50 percent ownership interest in an entity is presumed to have control or influence over the entity's trading decisions, but can seek disaggregation relief if the person certifies that the owned entity is not required under US Generally Accepted Accounting Principles (GAAP) to be consolidated on such person's financial statement and is not consolidated on such financial statement.¹⁰ The Commission proposed to require a notice filing regarding this and other conditions, proposing a case-by-case process to grant relief.¹¹ In the Notice, the Commission explained that while it will consider additional factors that demonstrate a lack of control between the person and owned entity, no combination of factors would guarantee that relief is appropriate.¹²

AGA commends the Commission for recognizing that in certain situations disaggregation relief may be warranted for majority owners, and thanks the Commission for revising its proposed rule accordingly. AGA maintains that aggregation is unnecessary to accomplish any regulatory purpose where a person lacks actual control or influence over the trading decisions of

¹⁰ 78 Fed. Reg. at p. 68960.

¹¹ *Id.* at p. 68959.

¹² *Id.* at p. 68960.

an owned entity, even a wholly-owned entity. AGA thus believes that the Commission's proposed requirement that such entities are not required under GAAP to prepare consolidated financial statements erodes the value of this discretionary process. AGA believes the Commission should revise its proposed conditions so that market participants are not precluded from seeking relief, even if they appear on a consolidated financial statement due to GAAP requirements or for other reasons.

The practical reach of the proposed exemptive process will be significantly and unreasonably limited if the Commission imposes a bright-line requirement that entities not be consolidated for financial reporting purposes in order to be eligible for relief since GAAP requires consolidation of any entity unilaterally controlled through majority voting interests.¹³ GAAP relies on voting control as a proxy for the ability to control day-to-day operating activities of the owned entity but does not depend on the existence of such day-to-day control. Because actual day-to-day control over, or coordination of, trading activity should be the Commission's regulatory concern, majority-owned entities should have a fair opportunity to demonstrate to the Commission that in spite of GAAP-required financial statement consolidation, an absence of actual trading control or coordination, together with other restrictions on information-sharing, justify disaggregation relief. AGA commends the Commission for seeking to provide market participants a genuine opportunity for relief, but respectfully requests that the Commission protect the value of this opportunity so that the mere fact of financial statement consolidation or majority voting ownership does not compromise a market participant's ability to seek relief where actual trading control and coordination do not exist.

¹³ See *Standards for Accounting Consolidation*, Report of the Counterparty Risk Management Policy Group (Aug. 6, 2008) available at: <http://www.crmpolicygroup.org/docs/CRMPG-III-Sec-II.pdf>.

Additionally, the Commission inquired in the Notice as to whether there are implications with respect to the interplay between disaggregation relief and the Commission's other rules relating to swaps, such as position limits on physical commodity swaps.¹⁴ AGA urges the Commission to recognize in this rulemaking that the true implications of disaggregation relief will not be readily apparent to physical commodity market participants until the Commission finalizes its rules regarding the scope of swaps, futures and referenced commodity contracts included in position limits. In particular, the Commission's ultimate treatment of trade options in the position limits rule may have a dramatic impact on whether or not affiliated energy business units with limited financial portfolios but extensive commodity portfolios, require disaggregation relief.

Utility businesses within larger holding structures may organize certain commodity contracting activities between and among themselves, which may have both elements of forwards and trade options. For example, a gas utility with a majority interest in a gas storage company may enter into a trade option with that storage company, for the future supply of gas commodity. The same utility may also enter into a trade option with a commonly held, affiliated marketer, and could exercise the delivery rights under one contract regularly while reserving the other to meet unanticipated needs. The manner in which each of these three business units organize physical contracting, however, is likely to be separate from how the entities organize their financial transactions.

Given any number of possible commodity supply arrangements within an energy company, a requirement in the position limits rule for the aggregation of physical commodity agreements could create undue hardships for energy end-users' supply management activities

¹⁴ *Id.* at p. 68963.

unless the Commission provides accessible, practicable means to seek disaggregation relief. Therefore, AGA believes that the conditions for seeking disaggregation under the Commission's proposal, as well as the proposed relief procedure under CEA § 4a(a)(8), should account for difficulties that utilities and other commercial businesses may face if required to aggregate physical commodity transactions that are used to manage reliability on behalf of their customers.

AGA maintains that as a matter of public policy, the Commission's determinations of aggregation of positions should be based on control over trading decisions and not ownership, even majority ownership. Even as the Commission may choose to administer a more detailed, discretionary process for disaggregation relief requests in cases involving majority ownership, the Commission should not bar any person, at any level of ownership, from attempting to make an affirmative demonstration of the lack of actual control.

B. The Commission Should Grant Temporary Relief For Such Time As It Takes To Make Its Required Determinations.

Under the Commission's proposal, relief for majority-owned entities would not be automatic, but would be available only if the Commission finds that such relief would be appropriate.¹⁵ In addition, the Commission's proposal does not impose any time limits on the Commission's process for making such determination and relief would be available only if and when the Commission acts on a particular request for relief.¹⁶ AGA is concerned about the amount of time that it may take for persons seeking relief to hear whether such relief will be granted given that Commission action is necessary for the relief to be granted coupled with the lack of any constraint on the amount of time the Commission may take to make a determination that relief is appropriate. As a result AGA members and other similar companies may be

¹⁵ *Id.* at p. 68960.

¹⁶ *Id.*

required to incur substantial costs to comply with the aggregation requirements while they await a response on their good faith requests for relief – costs which ultimately may be unnecessary. To prevent such a result, AGA respectfully requests that the Commission modify its proposal in this proceeding to grant temporary relief to an applicant seeking relief from the aggregation requirements while the Commission considers such request.

C. The Commission Should Consider Fulfillment Of Corporate And Fiduciary Duties As Independent Factors That Can Be Favorable To Granting Relief.

Under the Commission’s proposed exemptions for persons with ownership interests in an entity, a person must demonstrate a lack of control over an owned entity’s trading decisions, such that: (i) neither have knowledge of the trading decisions of the other; (ii) both trade pursuant to separately developed and independent trading systems; (iii) both have and enforce written procedures to preclude each from having knowledge of, gaining access to, or receiving data about trades of the other; (iv) such written procedures include document routing and other procedures or security arrangements, including separate physical locations, which would maintain the independence of their activities; (v) both do not share employees that control the trading decisions of either; and (vi) they do not have risk management systems that permit the sharing of trades or trading strategy.¹⁷

AGA thanks the Commission for proposing criteria that are workable for entities seeking disaggregation, so that they may share employees for risk management, accounting and compliance purposes, and mid- and back-office personnel, as long as such personnel do not control, direct or participate in trading decisions. AGA also appreciates the Commission’s clarification that sharing of risk management and compliance information would be permitted

¹⁷ *Id.* at p. 68952.

where used only for surveillance purposes rather than for trading purposes, and not shared with employees that control or influence trading decisions.

AGA supports the Commission's proposal to bring more flexibility to entities' ability to use the same off-the-shelf systems, and appreciates the clarification that restricted access and physical separation means more than simple physical separation of work desks.¹⁸ In prior comments, AGA had noted 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 believes this issue has been addressed in the Notice, as the Commission has proposed to condition permissible personnel sharing based on the lack of actual participation in trading decisions, rather than on a complete lack of knowledge about trading activities. Further, AGA supports the Commission's findings that these conditions should not require aggregation solely based on knowledge that a party gains when carrying out due diligence under a fiduciary duty, so long as that knowledge is not directly used to affect the entity's trading.¹⁹ Likewise, AGA supports the Commission's reasoning that the proposed conditions appropriately permit the sharing of board and advisory committee personnel, and employees for training, operational or compliance purposes, as long as those personnel do not influence or direct the entities' trading decisions.²⁰

Responding to the Commission's inquiry as to what additional factors might be favorable to granting relief for majority owners,²¹ AGA believes that the principles informing the Commission's proposed conditions for personnel-sharing should be applied more broadly to the

¹⁸ *Id.* at p. 68962.

¹⁹ *Id.* at p. 68961.

²⁰ *Id.*

²¹ *Id.* at p. 68963

discretionary process for granting relief to persons holding controlling interests in other entities.²² For example, a person should be able to cite fiduciary duty to demonstrate that even though the person has a voting or controlling interest in the entity, the exercise of decision-making power does not result in any effects on the entity's trading. Or, the person should be able to demonstrate that the sharing of its board members with a wholly-owned entity does not imply that shared corporate leadership knowledge is being used to influence trading strategies. AGA encourages the Commission to retain the view that even in instances of majority ownership in an entity, the exercise of personnel functions and the exchange of knowledge does not imply an ability to influence the entity's trading decisions.

D. The CFTC Should Codify Its Proposed Guidance On Information-Sharing Restrictions Under State, Federal, or Foreign Law.

In its discussion of the proposed exemption for information-sharing restrictions under state, federal, or foreign laws, the Commission provided detailed guidance regarding the support required to a reasonable risk of violation of law.²³ The Commission explained that if there is a reasonable risk that persons in general could violate such a regulatory impediment, then a memorandum may be prepared in a general manner rather than for a specific person, and may be provided by more than one person in satisfaction of the requirement.²⁴ The Commission also explained by example, that a trade association could retain outside counsel to provide such a memorandum on behalf of its members, as long as it is clear from the memorandum how the risk applies to the person providing the memorandum to the Commission as a basis for disaggregation. The Commission advised, however, that the legal memorandum need not be

²² *Id.* at p. 68960.

²³ *Id.* at p. 68950.

²⁴ *Id.*

complex, so long as it includes a detailed explanation of the effect of the law on the person's information sharing.²⁵ The Commission noted that the proposed rules do not include a complete list of the types of information that may be included in the memorandum, and stated that legal authorities deemed "state laws" can include rules, regulations, administrative rulings, fiduciary duties and court orders imposed by state commissions or other governmental authorities with jurisdiction.²⁶ The Commission further discussed that the issue of what legal authorities constitute relevant law should be addressed in the written memorandum of law, and that in general, any state-level legal authority that is binding on the person could be a basis for the exemption.²⁷

AGA commends the Commission for expanding this exemption to address a reasonable risk of violation of a state law and regulations, and for amending its proposal so that requirements under state law are a sufficient basis for claiming the exemption irrespective of comparable federal law.²⁸ AGA also supports the proposed modifications to the notice filing requirements that permit a market participant or its affiliate to prepare a memorandum of law, as opposed to a formal opinion of counsel, which sets forth a legal basis for the asserted regulatory impediment.²⁹ AGA believes that these proposed legal memorandum requirements, with all the guidance provided in the Notice, will allow gas utilities to present a complete picture to the Commission of the extent to which their affiliates are precluded from sharing information under a variety of restrictions established by state laws and regulations. AGA believes that this guidance is essential for inclusion in the Commission's final rule. Currently, proposed

²⁵ *Id.* at p. 68949-50.

²⁶ *Id.* at p. 68949.

²⁷ *Id.* at p. 68950.

²⁸ *See id.* at p. 68950-51.

²⁹ *See id.* at p. 68950.

regulation 150.4(b)(8) simply states that a memorandum of law is required to demonstrate a basis for the legal impediment asserted.³⁰

AGA respectfully requests that the Commission include, in its final regulatory text, or in formal guidance in the final rule's preamble, all elements of the discussion in the Notice as to what can constitute a state law, who may prepare the memorandum, and what must be included in the memorandum. AGA believes that these steps are necessary to ensure that the Commission's revised process for seeking relief has its intended effects – to provide clarity and legal certainty about the required contents of the memorandum, and to reduce administrative and legal costs for preparing such a document. AGA maintains that the Commission should not require a case-by-case petition approach for this exemptive process because it has the requisite tools to procure any and all of the information it seeks from applicants through the proposed notice and legal memorandum filing requirements.

IV. CONCLUSION

Wherefore, for the reasons stated above, the American Gas Association respectfully requests that the Commission revise its proposed exemption from aggregation based on majority ownership so that the mere fact of financial statement consolidation does not automatically preclude the person from seeking disaggregation relief. Moreover, AGA requests that the Commission grant temporary relief to an applicant seeking relief from the aggregation requirements while the Commission considers such request. In addition, AGA encourages the Commission to retain the view that even in instances of majority ownership in an entity, the

³⁰ *See id.* at pp. 68977-78, Proposed Section 150.4(b)(8) (stating that the notice should include a “written memorandum of law explaining in detail the basis for the conclusion that the sharing of information creates a reasonable risk that either person could violate state or federal law or the law of a foreign jurisdiction, or regulations adopted thereunder.”).

exercise of personnel functions and the exchange of knowledge does not imply an ability to influence the entity's trading decisions. Finally, AGA respectfully requests that under the proposed information-sharing restriction exemption, the Commission include in final regulatory text, or in formal guidance, all proposed clarifications regarding what constitutes a state law and how the required legal memorandum may be prepared.

Respectfully submitted,

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