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December 22, 2014

Chris Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Proposed Interpretation regarding Forward Contracts with Embedded Volumetric Optionality (RIN Number 3038-AE24)

Dear Mr. Kirkpatrick,

The American Gas Association (“AGA”) is pleased to submit these comments in response to the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) Proposed Interpretation on Forward Contracts with Embedded Volumetric Optionality (“Proposed Interpretation”). AGA thanks the Commission for the opportunity to provide comments, and commends the Commission for proposing to clarify the seven-factor analysis and related guidance. AGA urges the Commission to issue a final Interpretation no later than March 2015, to bring certainty to the physical natural gas marketplace before gas utilities undertake supply planning negotiations for peaking supplies and other forward contracts with flexible delivery rights to prepare for the 2015-2016 winter heating season. AGA believes a final Interpretation is required to restore gas industry confidence that peaking supply and other physical commodity contracts intended to be physically settled would fall within the forward exclusion from the swap and future delivery definitions in the Commodity Exchange Act. Without this clarification, natural gas utilities and consumers will continue to bear higher costs resulting from a decline in the number of counterparties willing to offer firm call rights under contracts with embedded volumetric optionality that utilities rely on to ensure reliable service to America’s natural gas consumers. Additionally, AGA requests that to the extent a 2014 calendar year Form TO deadline occurs before the Interpretation is released, the CFTC Division of Market Oversight should provide no-action

relief suspending the obligation to File Form TO until the Final Interpretation is issued. The no-action letter should also provide safe harbor to market participants who may have reported volumes on Form TO in 2014, but would apply the Final Interpretation in lieu of reporting on Form TO in 2015.

I. Statement of Interest

AGA represents more than 200 local energy companies that deliver clean natural gas throughout the United States. More than 65 million residential, commercial and industrial natural gas customers, or more than 175 million Americans, receive their gas from AGA members. 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 other regulatory authority with jurisdiction. They use financial tools to hedge the commercial risks associated with providing natural gas service to customers, such as commodity cost volatility. These tools include futures contracts traded on CFTC-regulated exchanges and over-the-counter energy derivatives. AGA members also participate in the physical natural gas market and contract for pipeline transportation, storage and asset management services in order to procure and deliver affordable, reliable natural gas to their customers. AGA members have an interest in transparent and efficient financial markets for energy commodities, so that they can engage in risk management activities at reasonable cost for the benefit of America's natural gas consumers. Under CFTC rules, AGA member companies are classified as non-financial entities, or "end-users" of futures and swaps.

II. Comments

In the Proposed Interpretation, the Commission stated its intent to provide additional clarifications to its interim final interpretation in the Product Definition final rule ("Products Release") concerning forward contracts with embedded volumetric optionality.¹ The Commission further explained that the Products Release interpretation was intended to

¹ See *Interim Final Interpretation, Further Definition of Swap, Security-Based Swap, and Security-Based Swap Agreement, Mixed Swaps*, 77 Fed. Reg. 48207, 48238-42 (August 13, 2012) [hereinafter, "Products Release"].

provide guidance to market participants about when an agreement, contract or transaction would fall within the forward contract exclusion from the “swap” and “future delivery” definitions in the Commodity Exchange Act, notwithstanding that it contains embedded volumetric optionality.² The Commission then noted that the Proposed Interpretation is an attempt to provide further clarifications, in response to comments made in the Product Release docket and at the CFTC’s End User Roundtable in April, 2014. The Commission also asked market participants to provide further information on why clarifying the guidance on embedded volumetric optionality in forward contracts was appropriate, and whether the exemptions for commodity trade options could provide sufficient relief.

As discussed further below, AGA supports the CFTC’s proposed revisions to the seven elements of its Interpretation, suggests additional clarifications and requests that a final Interpretation be issued promptly. Additionally, AGA contends that further changes for trade option reporting, in lieu of a final Interpretation regarding excluded forward contracts, would not reduce regulatory burden and marketplace uncertainty for natural gas end-users and their physical market, end-user counterparties. As AGA explained in its comments at the CFTC End User Roundtable, the trade option exemption has become a backstop for reporting physical contracts – which should be neither swaps nor trade options – because the seven-factor analysis in the Products Release was so unclear that market participants preferred to report out of an abundance of caution until the Commission could respond to comments filed in the Products Release docket, and provide a final rule or interpretation. AGA cautions that physical market participants are already discouraged from making certain commercial offerings to gas utilities because of the risk that CFTC Form TO will change in a manner that is unfavorable to the reporting of commercial transactions with embedded volumetric optionality. Therefore, AGA opposes any Commission action that would set aside the Proposed Interpretation and instead require physical market participants to rely on Form TO for reporting physical forward transactions. Such action would create a further drain on liquidity in the physical marketplace, as counterparties will hold back from offering services that might be classified as trade options,

² See Proposed Interpretation, at pp. 3.

reduce the availability of creative and flexible services that natural gas utilities rely on to serve customers, increase the price of services that do remain available, and lead to increased costs passed through to energy consumers. AGA also contends that the CFTC's excluded forward contract interpretation provides important regulatory benefits that are in the public interest – through a substantial reduction in regulatory burden for end-users and reduced costs passed on to consumers – and that these benefits far outweigh any regulatory interest the CFTC may have in regulating end-users' nonfinancial, physically-settled energy delivery agreements as “trade options”.

For these reasons, AGA urges the Commission to finalize its Proposed Interpretation no later than March 2015, so that natural gas utilities may rely on the clarity and regulatory certainty of a final interpretation when negotiating with physical market counterparties for contractual terms that will adequately and competitively serve their 2015-2016 winter heating season needs while ensuring continued reliability at least cost to America's energy consumers.

A. AGA Supports Proposed Changes to the Seven Elements of the Interpretation and Requests Clarifications that will Assist Natural Gas Utilities in Applying the Excluded Forward Contract Analysis to Peaking Supply Contracts.

The CFTC has proposed changes to the fourth and fifth factor, and the seventh factor, of its “seven-factor analysis” in the Products Release, under which an agreement, contract or transaction would fall within the forward exclusion from the swap and future delivery definitions, notwithstanding that it contains embedded volumetric optionality, when these seven factors are satisfied. Under the proposed changes, the seven-factor analysis would provide a regulatory exclusion for a physical contract with embedded volumetric optionality when:

- (1) The embedded optionality does not undermine the overall nature of the agreement, contract, or transaction as a forward contract;
- (2) The predominant feature of the agreement, contract, or transaction is actual delivery;

- (3) The embedded optionality cannot be severed and marketed separately from the overall agreement, contract, or transaction in which it is embedded;
- (4) The seller of a nonfinancial commodity underlying the agreement, contract, or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction to deliver the underlying nonfinancial commodity if the embedded volumetric optionality is exercised;
- (5) The buyer of a nonfinancial commodity underlying the agreement, contract or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction, to take delivery of the underlying nonfinancial commodity if the embedded volumetric optionality is exercised;
- (6) Both parties are commercial parties; and
- (7) The embedded volumetric optionality is primarily intended, at the time that the parties enter into the agreement, contract, or transaction, to address physical factors or regulatory requirements that reasonably influence demand for, or supply of, the nonfinancial commodity.

The CFTC has proposed that the fourth factor would be revised to add “embedded volumetric” before “optionality is exercised.” The fifth factor would be revised to replace “if it exercises the embedded volumetric optionality” with “if the embedded volumetric optionality is exercised”. The seventh factor would be revised wholesale to replace the current Interpretation’s text, which states: “The exercise or non-exercise of the embedded volumetric 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.”

AGA appreciates the CFTC’s discussion in the Proposed Interpretation that the proposed revisions to the seventh element would address concerns raised by the AGA, to accommodate contracts under which parties cannot predict their exact delivery needs at contract initiation due to a variety of factors, such as weather and operational conditions like transportation capacity. The CFTC also stated that under the proposed revision, the embedded volumetric optionality would be covered by the seventh factor where it “offers

commercial parties the flexibility to vary the amount of the nonfinancial commodity delivered during the life of the contract in response to uncertainty in the demand for or supply of the nonfinancial commodity.” The CFTC cited, as support for this view, a letter from the AGA stating that “‘weather-sensitive demands’ for natural gas ‘cannot be accurately predicted in advance’”. The CFTC added that to be consistent with the historical interpretation of a forward contract, the embedded volumetric optionality “must primarily be intended as a means of assuring a supply source or providing delivery flexibility in the face of uncertainty regarding the quantity of the nonfinancial commodity that may be needed or produced in the future, consistent with the purposes of a forward contract.”

Regarding the proposal to remove language in the seventh element on physical factors and regulatory requirements “outside the control of the parties”, the Commission believed this change would clarify that “whether the parties have some influence over factors affecting their demand for or supply of the nonfinancial commodity (e.g., the scheduling of plant maintenance, plans for business expansion) would not be inconsistent” with the seventh element, provided that the “embedded optionality is included in the contract at initiation primarily to address potential variability in a party’s supply of or demand for the nonfinancial commodity.”

AGA agrees with the Commission that the proposed removal of the seventh element language on “exercise or non-exercise” of optionality will help correct the misinformation and confusion that is currently driving some natural gas market participants to require that their counterparties make specific representations that any exercise or non-exercise of delivery rights under a forward contract with embedded volumetric optionality requires additional analysis under the CFTC’s Interpretation. AGA supports the proposed removal of this language, which will help clarify to the industry that the seventh element focuses on physical settlement, and the intent of parties to physically settle, and not on subsequent business decisions made to make or take delivery by exercising the underlying physical settlement rights. AGA also requests that the Final Interpretation include the proposed guidance that contracts with embedded volumetric optionality should be covered by the seventh element when the optionality offers commercial parties the flexibility to vary the

amount of the nonfinancial commodity delivered, during the life of the contract, in response to uncertainty in the demand for or supply of the nonfinancial commodity.

AGA reiterates that gas utilities are entering into non-financial, forward contracts with embedded volumetric optionality with a wide variety of counterparties, the majority of which are non-bank, non-swap dealer entities. These counterparties include on-system and off-system storage providers, affiliated and un-affiliated natural gas marketers, asset managers, small producers, and gas utilities' industrial customers that have available capacity because of their fuel switching capabilities. AGA believes the proposed revisions to the seventh element should help restore confidence in this end user-driven segment of the marketplace that physical transactions, intended to be physically settled through either making or taking delivery of a natural gas commodity, are within the forward exclusion from the swap and future delivery definitions.

Therefore, AGA respectfully requests that the CFTC explicitly state in either the seven-element analysis preamble language, or in an explanatory paragraph following the analysis, that: the seven factors would be generally satisfied when the optionality embedded in a forward contract is primarily intended as a means of assuring a supply source or providing delivery flexibility in the face of uncertainty regarding the quantity of the nonfinancial commodity that may be needed or produced in the future, consistent with the purposes of a forward contract. We also request that the Commission finalize its proposal to permit parties to rely on counterparty representations with respect to the intended purpose for embedding volumetric optionality in the contract, so that natural gas utilities and their diverse counterparties may confidently negotiate terms for peaking supply agreements that permit a natural gas utility the right, but not the obligation, to take firm quantities under commodity contracts where the utility has stated its intent to take physical delivery at the time of contract initiation.

The Commission proposed to retain language in the seventh factor regarding physical factors or regulatory requirements. In explaining the intent and scope of "physical factors" that are consistent with the seventh element, the CFTC proposed to clarify that this reference to "physical factors" should be construed broadly to include any fact or

circumstance that could reasonably influence supply of, or demand for, a nonfinancial commodity under the contract. As examples, the CFTC cited weather, location, operational considerations like the availability of reliable transportation, and system reliability issues that lead to voluntary supply curtailments. However, the CFTC added that “concerns that are primarily about price risk (e.g., expectations that the cash market price will increase or decrease)...would not satisfy the seventh element absent an applicable regulatory requirement to obtain or provide the lowest price (e.g., the buyer is an energy company regulated on a cost-of-service basis.)”.³

With respect to the Commission’s proposed clarification linking consideration of price risks to a regulatory requirement to obtain the lowest price, AGA is concerned that this discussion could unintentionally narrow the scope of relief provided by the Interpretation to natural gas utilities. AGA has explained in prior comment letters that our members have an obligation to provide natural gas commodity sales and distribution service to their retail customers under rates, terms and conditions that are regulated at the local level by state commissions or other regulatory authorities with jurisdiction. AGA reiterates here that our members’ regulatory obligation to provide service means they have an obligation to hold the requisite assets necessary to meet variable customer demand throughout the year. As part of performing natural gas sales and distribution functions, gas utilities develop detailed long-term plans that are subject to periodic update, review and approval processes. The purpose of these plans is to ensure that gas utilities can reliably meet the physical demand for service on peak days, at the lowest reasonable cost. This process includes building and managing portfolios of physical natural gas supply, and building or contracting for storage and pipeline transportation services in order to meet

³ In support of this analysis, the CFTC cited a letter from the FERC Office of General Counsel, which states, in part, that “in the case of many energy transactions, the purchaser (i.e. the option holder), when faced with a need for additional supply as a result of external factors (e.g., a spike in demand), may have a variety of choices...if such a need arises, the buyer may have other, less expensive, ways to meet increased demand”. The letter from FERC also stated that “if a buyer is regulated on a cost-of-service basis and chooses the least-cost approach under the circumstances, it is unclear whether its action would be considered [by the CFTC] as based on a ‘regulatory requirement’”. See [Letter from the Office of General Counsel](#), Federal Energy Regulatory Commission (Oct. 12, 2014), at pp. 4.

anticipated peak day customer needs. In this regard, the predominant physical factor driving a gas utility's decision to enter into a natural gas peaking supply agreement, or any other contract with embedded volumetric options, is to have natural gas supplies available as part of the utility's portfolio of assets to respond to changes in customer demand or to meet operational needs.

In the process of meeting this regulatory obligation to serve, a gas utility must make prudent, cost-effective choices in building an asset portfolio that will effectively serve its customers – including the consideration by either the utility, its counterparty, or both, of price risks associated with securing a contract for a specific asset. AGA notes that a gas utility's counterparties are diverse in size as they are in CFTC entity status – from small producers and marketers and commodity asset managers, to larger producers and banks' and oil majors' commodity desks. In negotiating for firm physical supplies with these counterparties, the gas utility will use reasonable business judgment, as required by its state regulators, to consider timing, system operations, costs, and customer needs in determining whether to enter into any given supply arrangement with embedded volumetric optionality. Clearly, a consideration of price will feature prominently in the course of making prudent business judgments about how to meet this physical demand consistent with the utility's obligation to serve. For these reasons, AGA respectfully contends that the Commission's proposed discussion regarding price risks may unintentionally narrow the circumstances under which a gas utility could apply the seventh element to its physical contracts.

AGA also believes that the proposed discussion regarding price risks may unintentionally narrow the scope of the Interpretation beyond what the Commission itself provided in the original Products Release guidance. Specifically, the Commission stated in the Products Release guidance, that "the seventh element is based on comments stating that parties to agreements, contracts, and transactions with embedded volumetric optionality intend to make or take delivery (as applicable) of a commodity, and that it is merely the volume of a commodity that would be required to be delivered if the option is exercised, that varies. It is designed to ensure that the volumetric optionality is primarily driven by physical factors or regulatory requirements that influence supply and

demand...and that the optionality is a commercially reasonable way to address uncertainty associated with those factors.”⁴ The Commission cited as direct support for this proposition, AGA comments which advised the Commission that retail demand for natural gas is weather-driven, and resultantly, a gas utility’s peaking supplies must have significant flexibility, and gas utilities must use a variety of contracts with gas suppliers, to physically deal with peak periods of demand.⁵ AGA had also explained in those comments, that as the prices AGA members pay for natural gas are passed on to ratepayers, AGA members have a clear incentive to acquire these supplies at the lowest possible cost that allows the reliable operation of their systems in a commercially reasonable manner.

AGA contends that, in line with the guidance the Commission has already provided in the Product Release, it is consistent with the seventh element that gas utilities consider price risks in the course of making reasonable, prudent business judgments about the commercial terms under which they will secure rights to physical supply to meet variable customer demand. In addition, AGA respectfully notes that it would be arbitrary for the Commission to first provide in its Products Release guidance that the embedded optionality must be a “commercially reasonable way to address uncertainty associated with [physical] factors” and then subsequently conclude in its additional Interpretation that a commercial party’s consideration of price risk would not be a commercially reasonable basis for entering into contracts with volumetric optionality to address uncertainty associated with physical factors. Therefore, AGA requests that the Commission remove the proposed Interpretation’s discussion regarding price risks.

With respect to the proposed explanation of “regulatory requirements”, AGA appreciates the Commission’s inclusion of an energy industry example noting that agreements consistent with the seventh element would include those informing “a key function of an electric system operator to ensure grid reliability... even if not specifically mandated by a system operator”. Given this example and others appearing in the proposed

⁴ Products Release, 77 Fed. Reg. at 48239 [note: the omitted portion of this quotation refers language regarding “outside the parties’ control”, which would no longer be applicable under the final Interpretation if the Commission adopted its proposed revision to the seventh element].

⁵ See *id.*, at n.345.

Interpretation, AGA believes the Commission should provide a streamlined, generally applicable statement in the final Interpretation that economic decisions made in the course of entering into physical supply contracts intended to be physically settled to ensure system reliability, may be consistent with the seventh element's "regulatory requirements" clause. Additionally, we respectfully request that the final Interpretation clearly state that energy utilities bearing an obligation to serve under rates, terms and conditions specified by a regulatory authority, may consider economic factors in the course of contracting for physical reliability, as the product of physical factors or regulatory requirements, consistent with the seventh element.

Finally, AGA requests that the final Interpretation provide explicit clarification that natural gas peaking supply contracts fall within the forward contract exclusion and seven-part analysis, as the parties to these contracts agree to buy or sell a nonfinancial gas commodity and intend, at the time of contract initiation, to execute physical delivery of the commodity if the volumetric optionality is exercised. Such clarification should address AGA's outstanding Request for Interpretative Guidance,⁶ and provide appropriate guidance to gas utilities that such peaking supply agreements may be excluded because at the time of contract initiation, they assure a secured right to call on physical delivery of supplies that gas utilities would otherwise have to procure unsecured in the natural gas spot market to ensure reliable service to customers.

AGA notes that the prompt finalization of the Proposed Interpretation is an opportunity for the Commission to reduce misplaced regulatory burdens on end-users and mitigate the additional costs that this regulatory uncertainty has passed on to America's energy consumers. A final rule regarding the definition of "swap" is crucial to understanding the universe of products that will be regulated by the Commission, and end-users cannot make this determination as a certainty without final guidance on forward contracts excluded from the "swap" definition. In addition to finalizing this Interpretation, AGA requests that the Commission take appropriate steps to ensure that the final Interpretation is accessible

⁶ See AGA Request for Interpretative Guidance on the Treatment of Certain Natural Gas Supply Contracts with Volumetric Optionality, RIN 3038-AD46; RIN 3038-AD62 (Filed with Richard Shilts, Division of Market Oversight, February 22, 2013).

to all market participants through proper codification in the CFTC regulations pertaining to the definition of “swap”. AGA also requests that the Commission take appropriate steps to ensure that the CFTC Office of General Counsel’s guidance on the “swap” definition and seven-factor analysis is also incorporated into the swap definition regulations.⁷

AGA reiterates that time is of the essence -- the final Interpretation should be issued by March 2015, so that physical market confidence can be restored prior to the time when gas utilities will commence building their portfolio of flexible physical contracts, particularly peaking supply contracts, to prepare for the upcoming winter heating season months of November 2015 through March 2016. Additional contractual planning is also required for unexpected increases in customer demand that would be served by peaking services in the “shoulder months” of October and April, a band of weeks or days that “cap” the typical winter heating season. Gas utilities will begin negotiating for peaking supply and other flexible delivery services to meet these various requirements, beginning in Spring 2015. A final Interpretation made available during this time will ensure that the excluded forward contract relief actually benefits end-users, commercial market participants and consumers.

Additionally, AGA notes that because the timing of a final interpretation may result in the 2014 calendar year Form TO deadline occurring before the Interpretation is released, Commission staff should provide no-action relief suspending the obligation to File Form TO until the Final Interpretation is issued. Without such relief, some market participants may report the exercise of certain embedded volumetric options on Form TO and would be unable to avail themselves of a subsequently-issued Interpretation. The no-action letter should also provide safe harbor to market participants who may have reported volumes on Form TO in 2014, but would apply the Final Interpretation in lieu of reporting on Form TO in 2015.

⁷ See Response to Frequently Asked Questions Regarding Certain Physical Commercial Agreements for the Supply and Consumption of Energy, available via CFTC [website](#).

B. AGA Believes that the Finalization of the Proposed Interpretation is in the Public Interest, Providing Necessary Certainty to Natural Gas Markets and Reducing Costs for Gas Utilities and their Customers.

Supplementing the Proposed Interpretation, the CFTC requested public comments on additional topics related to the seven-factor analysis and the interim final rule providing a commodity trade option exemption. The CFTC provided a list of questions and points, requesting further information from market participants:

Q: Market participants have expressed concerns about whether various types of volumetric optionality fit within the CFTC's interpretation. The CFTC recognizes that, since the interpretation is not intended to provide relief for all forms of embedded volumetric optionality, there are likely to remain concerns within the industry about the treatment of embedded volumetric optionality within forward contracts. The CFTC notes that, in April, 2012, the CFTC adopted an Interim Final Rule for Commodity Options (the "IFR"). Even if a contract with volumetric optionality does not fit within the seven elements of the interpretation, the CFTC believes there is widespread agreement that contracts that fail one or more of the seven elements of the CFTC's interpretation would fall within the exemption from most swaps regulation provided by the IFR. Therefore, it appears that the IFR provides a clear and well understood mechanism through which contracts with volumetric optionality can be exempted that avoids many of the difficulties of determining whether a particular contract with volumetric optionality would satisfy the seven elements of the CFTC's interpretation. The CFTC invites comment on whether the IFR's approach to defining the universe of swaps subject to its exemption may provide a clearer and easier mechanism for providing relief from swaps requirements than the CFTC's interpretation of forwards with embedded volumetric optionality and whether the IFR currently provides sufficient relief for such contracts.

Q: Market participants have argued that the lack of clarity around the seventh element of the CFTC's interpretation has led to costs to end-users. Conceivably, since contracts that fail one or more of the seven elements would be regulated as exempt commodity trade options under the IFR, these costs are attributable to complying with the IFR. The CFTC invites comment on whether or not this is the case, and invites the submission of data quantifying those costs.

Q: What factors should the CFTC consider in determining whether the proposed modifications and clarifications to the CFTC's interpretation are appropriate in view of CFTC precedent regarding the interpretation of the CEA's forward contract exclusion? Do the proposed changes provide sufficient clarity on how contracts with embedded volumetric optionality may satisfy all seven elements of the interpretation, particularly the first and second elements? Are there reasons why trying to provide further relief through the swap definition's forward contract exclusion would not be in the public interest?

In addition to the points made above regarding the necessity of a final Interpretation, AGA provides the following additional responses to questions posed in the proposal.

First, AGA respectfully disagrees with the Commission's observation that there is "widespread agreement" in the industry that a contract which fails one or more of the seven factors should automatically fall within the limited exemption from certain swap regulations provided by the interim final exemption for commodity trade options. AGA asserts that to the contrary, certain contracts with volumetric optionality are being treated as *de facto* trade options only because there is widespread *disagreement* as to whether a contract which may not fit the Commission's seven-factor analysis. To the extent market participants are reporting such transactions as trade options, they are not doing so because the industry has reached some broad consensus on the issue, but because they are waiting for the Commission to make a clear determination of what contracts it does not intend to regulate now, and what contracts it *might* have a future interest in regulating through reporting on Form TO. And, in the interim, market participants have gravitated towards widespread reporting of physical transactions as trade options so they can protect themselves against regulatory risk associated with a potential future Commission decision that such transactions *are* swaps. As such, the widespread reporting of physical natural gas contracts on Form TO is the product of market participants viewing the Commission's interim final trade option rule and interim final Interpretation in the Products Release as putting these contracts in regulatory limbo.

Second, AGA urges the Commission to recognize that there is a unique and substantial benefit to the public interest from clarifying the forward contract exclusion, which is not outweighed by any regulatory interest the Commission may have in receiving aggregated data on Form TO regarding the nonfinancial business transactions of commercial end-users. The benefits to natural gas utilities and their customers alone, should be a substantial factor in favor of finalizing this interpretation. Natural gas utilities are a uniquely important energy stakeholder group that needs this clarification, because they rely on firm, secured rights to call on gas, *i.e.* an option but not an obligation to take physical delivery, under peaking supply and other longer-term physical forward contracts that allow them to reliably meet system load swings in times of expected and unanticipated

demand. Meeting these requirements is not aspirational – it is an obligation to serve energy consumers reliably, at lowest reasonable cost, in all weather conditions, throughout the year. The substantial customization and innovation that goes into arranging peaking supply and other firm delivery agreements between utilities and their supplier counterparties, reflects the high variability in consumer demand throughout the year that utilities must address in each of their service territories as part of this obligation.

Confusion among utilities and their counterparties about whether they can avail themselves of the forward contract exclusion has stifled gas market innovation to a significant enough degree that utilities are seeing higher prices for the same services and firm call rights they have traditionally purchased in a liquid and robust physical marketplace. As more marketplace counterparties are deterred from entering into firm contracts because of uncertainty that the contracts may be swaps, gas utilities are being forced to turn to the spot market for the same supplies, without the secure rights to call from suppliers that they would have under peaking agreements. AGA emphasizes that many of our members have noted significant difficulties in procuring peaking supply contracts for the past winter heating season, because traditional counterparties like small producers and marketers could not reach agreement on whether peaking supply contracts fell within the CFTC's seven-part analysis for forward contracts with embedded volumetric optionality.

Third, not only does a lack of clarity around the forward contract exclusion create a serious loss of security for utilities, the public interest is disserved by the resulting increase in commodity procurement costs that are passed through to America's energy consumers on their gas bills. Reducing volatility in commodity procurement costs, particularly during cold weather events and other constrained periods of high demand, is contingent in great part on a gas utility's portfolio of readily available, firm rights to call on gas under peaking supply contracts that guarantee delivery at a specific price. As AGA has explained in greater detail in its Request for Interpretative Guidance, gas utilities will schedule delivery under some, all or none of the available firm commitments they have contracted for under peaking agreements, depending on several factors including whether least cost supplies can be obtained for their customers from alternative sources such as storage or swing

contracts, and depending on whether additional peaking quantities contracted for, are necessary for future anticipated or unexpected increases in demand. The more difficult it is for gas utilities to procure these services in a tight marketplace, the more likely it is that they will pay, and pass on to consumers, the costs of more expensive service alternatives that are still available to meet the same gas supply needs.

These consequences are precisely what many AGA members are reporting as having occurred in the planning and execution of portfolio contracting for meeting the challenging conditions presented by the 2013-2014 winter heating season. These trends also demonstrate that Form TO reporting for physical gas transactions is largely a stand-in for the lack of regulatory clarity surrounding the seven-factor analysis. Under these circumstances, the excluded forward contracts interpretation is being under-utilized by the very market participants that it was designed to benefit. Further, it is unclear why the Commission would have a reasonable or significant regulatory interest in the inaccurate reporting of such transactions on Form TO. Given these considerations, AGA believes the public interest – that of regulated end-users and consumers – is served by clarification to the forward contract exclusion Interpretation.

Fourth, AGA members note that to the extent that counterparties have agreed that certain supply contracts are in fact excluded forwards, or otherwise should be reported out of an abundance of caution on Form TO, there remains significant concern that Form TO reporting will create regulatory risk if some parties report these agreements, while others do not. Given the widespread concern about regulatory exposure if physical transactions are not reported on Form TO, gas utilities have observed that the physical marketplace has shifted towards Form TO reporting without any consideration of the embedded volumetric optionality exclusion as a possible path forward for certain physical delivery agreements.

Additionally, counterparties that are willing to offer peaking supply and other flexible delivery options, have significantly limited these offerings to conform to Form TO reporting, expressing serious concerns that Form TO requirements could morph into more expensive, impracticable and onerous regulation of physical products under a regime designed for financial products. Even as certain Commission staff have informally stated to market

participants that Form TO is designed as a “regulation light” alternative to swaps reporting, the industry cannot help but wonder how aggregated Form TO data containing large amounts of non-financial, physical marketplace data would have any value to the Commission or to the public, especially when compared to the real-time reporting of financial swaps data that is the centerpiece of Dodd-Frank regulation. In light of this uncertainty, AGA members have noted that Form TO reporting continues to be a deterrent to participation in physical marketplace and will stifle counterparties’ contractual offerings unless clarification is provided through the excluded forward contract Interpretation. In these many respects, the commodity trade option exemption does not provide a clear and well-understood mechanism for reporting physical natural gas agreements – because Form TO is not a clear path forward for reporting physical transactions that should not be regulated as “swaps”, gas utility counterparties have shied away from entering into transactions that may be characterized as a trade option.

Fifth, as to specific costs, AGA members continue to provide significant anecdotal evidence of the contracting costs borne by the natural gas market and by individual companies, in light of the confusion surrounding the seven-factor analysis. Many members have noted a drop-off in contract offerings for peaking supply terms and conditions that provide for “firm” delivery to manage demand in the winter heating season, because of potential counterparties’ concern that non-exercise of firm delivery rights may be viewed under the seven-factor analysis as a “non-exercise” that does not meet the analysis’ physical settlement requirement. As such, the costs which the Commission should consider, do not arise merely from the recharacterization of forward contracts as commodity trade options, but from the substantial decrease in contractual offerings in the first instance, because of the perceived risk that these contracts will be incorrectly categorized and regulated as a “swap”. And, as discussed above in AGA’s comments, as the number of counterparties offering these services has fallen, the price for alternative services to meet the same needs, has risen.

Finally, AGA notes that the Products Release, and within it the Commission’s interpretation regarding excluded forward contracts, is a cornerstone of the Commission’s regulation of swaps. Without a clear rule for industry to apply in determining which

contracts are “swaps” and which are not, the public interest in transparent, efficient regulation of financial swaps activity will not be met. For one, the mischaracterization and reporting of physical forward contracts as commodity trade options will continue to present a muddled picture of commodity option activity, to the Commission, as well as to the public and to end-users like gas utilities that stand to benefit from public reporting of financial markets activity. The commodity option data generated from the energy industry alone, already provides a very substantial amount of information about the physical marketplace, which the Commission will need to interpret. AGA therefore respectfully notes that a continued attempt to include physical forwards reporting in Form TO, will become a significant distraction to the Commission from its fundamental task under the Dodd-Frank Wall Street Reform and Consumer Protection Act – the identification and correction of fraudulent and manipulative financial markets activity. Further, the continued uncertainty associated with potential recharacterization of physical forwards as “swaps” or “trade options” will continue to discourage physical natural gas market counterparties from entering into peaking supply agreements and other contracts that gas utilities use to ensure firm delivery of physical energy on an as-needed basis, particularly during cold weather months.

The natural gas marketplace needs assurance that non-financial contracting practices will not be at risk of being regulated as financial swaps. Without this assurance, natural gas utilities will continue to face a constrained marketplace for the contractual services they need to deliver reliable energy to consumers at affordable, stable prices. As the United States enters an age of natural gas abundance with relatively stable, long-term prices, the CFTC should issue clear rules and regulations that promote the ability of energy end-users to harness this opportunity through innovative contracting practices that provide reliable, affordably-priced energy to American consumers.

III. Conclusion

For the reasons discussed above, AGA believes that finalizing the Commission’s Proposed Interpretation is in the public interest, and should be undertaken promptly to provide necessary clarity to natural gas utilities and their physical marketplace

counterparties. AGA requests that the Commission issue a final Interpretation, with the additional clarifications AGA has requested herein, no later than March, 2015. Additionally, AGA requests that Commission staff in the Division of Market Oversight provide temporary no-action relief to all market participants reporting on Form TO for calendar year 2014 until such time as the Final Interpretation is issued and market participants can make an adequate determination of whether certain physical forwards may be excluded from reporting. In the same no-action relief, AGA requests that the Commission provide safe harbor to those market participants and their counterparties who may have reported certain physical natural gas transaction volumes on Form TO for calendar year 2013, but would reach a reasonable conclusion under the Final Interpretation that the contracts under which those volumes were reported, would be excluded from further TO reporting.

AGA thanks the Commission for undertaking this important initiative to provide relief to end-user market participants, and commends the Commission staff for working with AGA and other stakeholders to understand the issues that must be addressed through changes to the seven-factor analysis. We look forward to a Final Interpretation that will provide our membership necessary relief and guidance, and remain available to answer any additional questions or concerns that the Commission may have in the course of resolving this issue.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Arushi Sharma Frank", with a stylized flourish extending to the right.

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