May 9, 2016

Via Electronic Submission

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Comments of the American Gas Association, CFTC Proposed Guidance – Certain Natural Gas and Electric Power Contracts, RIN 3235-AL93

Dear Mr. Kirkpatrick:

Pursuant to the request for comments, the American Gas Association ("AGA") respectfully provides these comments on the Commodity Futures Trading Commission's ("CFTC" or "Commission") and the Securities and Exchange Commission's Proposed Guidance re: Certain Natural Gas and Electric Power Contracts ("Proposed Guidance").[1]

AGA appreciates that in the Proposed Guidance, the Commission has endeavored to provide additional certainty that certain natural gas and electricity contracts should be considered not to be "swaps" under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") amendments to the Commodity Exchange Act (the "CEA"), and the related Commission interpretations in the "Products Release."[2] Over the last several years, AGA has sought clarification that physical natural gas contracts with volumetric optionality, commodity trade options and other operational contracts, entered into by its natural gas utility members as part of their public service obligation to reliably meet the natural gas needs of their residential, commercial and industrial customers, should not be considered "swaps."[3] AGA believes that the Proposed Guidance, while currently too limited to be useful for AGA members, is another welcome effort by the Commission in terms of providing regulatory certainty that the natural gas and electric utility industries have been requesting. The Proposed Guidance outlines an approach toward evaluating such transactions that, AGA believes, should be extended to provide the additional guidance that AGA has been requesting for similar types of contracts.

Accordingly, AGA respectfully requests that the Commission extend the Proposed Guidance to provide additional certainty to natural gas utilities by confirming in any subsequent or finalized guidance that it applies to equivalent natural gas peaking supply contracts entered into by natural

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[1] Proposed Guidance, Certain Natural Gas and Electric Power Contracts, 81 Fed. Reg. 20583 (April 8, 2016).
[2] Further Definition of Swap, Security-Based Swap, and Security-Based Swap Agreement, Mixed Swaps, Final Rule and Interpretations, 77 Fed. Reg. 48207 (August 13, 2012)(the "Products Release").
[3] *See, e.g.*, Comments of the American Gas Association, RIN 3038-AD46 (July 22, 2011 and Oct. 12, 2012); Comments of the American Gas Association, RIN 3038-AD62 (July 26, 2012); AGA Request for Interpretative Guidance on the Treatment of Certain Natural Gas Contracts with Volumetric Optionality, RIN 2028-AD62 (February 22, 2013); Comments of American Gas Association, RIN 3038-AE24 (December 22, 2014); and Comments of American Gas Association, RIN 3038-AE26 (June 22, 2015).

gas utilities.[4] As discussed herein, these contracts align with the characteristics described in Part II.A.2 in the Proposed Guidance and thus should not be considered "swaps" for the reasons discussed in the Proposed Guidance.

I. Communications

All correspondence in regard to this proceeding should be delivered to the following:

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II. Identity and Interests

The AGA, founded in 1918, represents more than 200 local energy companies that deliver clean natural gas throughout the United States. There are more than 72 million residential, commercial and industrial natural gas customers in the U.S., of which 95 percent – just under 69 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 more than one-fourth of the United States' energy needs.[5]

AGA member companies provide natural gas local distribution services to residential, commercial and industrial customers under rates, terms and conditions that are regulated at the local level by a state utility commission or other regulatory authority with jurisdiction. In most cases, this regards the procurement and provision of physical natural gas commodity for use by customers in equipment in their homes and businesses, and the distribution of that natural gas commodity to such homes and businesses. To ensure reasonable rates for the natural gas commodity that is provided to natural gas utility customers, AGA's members engage in risk management transactions in markets regulated by the Commission. Many gas utilities also use a variety of financial tools, such as futures contracts traded on Commission-regulated exchanges and over-the-counter ("OTC") energy derivatives, to hedge the commercial risks associated with providing safe, reliable and cost-effective natural gas service to its customers.

[4] For these purposes, the relevant definition in the Federal Energy Regulatory Commission ("FERC") Glossary to refer to is "local distribution company" [an "LDC"] which is defined as, "any [generally state-regulated] firm, other than a[n] [interstate] natural gas pipeline, engaged in the transportation or local distribution of natural gas and its sale to customers that will consume the gas." Also, "distribution" is defined as, "for natural gas - the act of distributing gas from the city gate or plant to the customer." Note, these local distribution utility companies in their distribution functions are not subject to FERC jurisdiction under the Natural Gas Act, but they are generally subject to FERC jurisdiction as natural gas market participants, as holders of limited-jurisdiction certificates, or for other aspects of their commercial natural gas business within a larger commercial enterprise or corporate family.

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

III. Comments

A. The Commission Should Provide Guidance That Certain Natural Gas Peaking Supply Contracts Entered Into By Natural Gas Utilities Are Not Swaps

AGA appreciates the Commission's efforts to provide clarity regarding the treatment of certain customary arrangements used by commercial market participants to provide for the supply and delivery of natural gas and electric power.[6] However, the Proposed Guidance is too narrow.[7] While the Proposed Guidance discusses natural gas "peaking" supply contracts,[8] it is limited to narrow transactions entered into by *electric utilities*.[9] Given this, the Proposed Guidance currently cannot be read to apply to similar and customary firm natural gas peaking supply contracts[10] entered into by *natural gas utilities*. For the reasons discussed in these comments, AGA respectfully requests that the Commission extend the Proposed Guidance to confirm that equivalent natural gas peaking supply contracts entered into by natural gas utilities and which manifest the general characteristics described in the Proposed Guidance, should also not be considered "swaps."

1. Background on Natural Gas Utility Contracting Practices

By way of background, and as described in previous filings, AGA members provide natural gas utility services to residential, commercial and industrial customers under rates, terms and conditions that typically are regulated at the local level by a state utility commission or other regulatory authority with jurisdiction.[11] In most cases, the service that is provided includes both the procurement and provision of the natural gas commodity for use by customers in equipment (such as furnaces and water heaters) in their homes and businesses, as well as the associated distribution service which involves the movement of the gas commodity through the gas utility's local pipeline system[12] to such homes and businesses.[13]

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[6] *See* Proposed Guidance, Certain Natural Gas and Electric Power Contracts, Appendix 2 – Statement of CFTC Chairman Timothy Massad, 81 Fed. Reg. at 20587 (April 8, 2016).
[7] *See*, Proposed Guidance, Request for Comment question 4, 81 Fed. Reg. at 20586.
[8] *See*, Proposed Guidance at 20584.
[9] *Id.*, and footnote 14 defining the term "electric utility" for purposes of the Proposed Guidance.
[10] The reference to "peaking" as used herein describes natural gas transactions entered into by natural gas utilities with variable quantity terms, sometimes also referred in the gas industry as "peaking," "swing," "daily swing," "recall," "volumetric optionality," "variable quantity," and other terminology to describe similar transactions.
[11] The regulated service provided by natural gas utilities does not include the generation, purchase or sale of electricity. An entity that owns a natural gas-fired electric generation facility (whether an electric utility or another type of generation owner), is different from a natural gas utility that, by definition, provides natural gas service, not electric service, to its customers.
[12] Gas distribution systems differ, but generally consist of: high pressure transmission lines, lower pressure mains and service lines, gas flow regulators, a wide variety of meters, SCADA systems, and odorization equipment. The systems may include on-system storage or connections to off-system storage, LNG storage and conversion equipment, and propane-air.
[13] There are different types of gas utility customers and services. Sales service, generally provided to residential and commercial customers, refers to a "bundled" service where the service rate includes both the pass-through of natural gas commodity costs and the cost of moving the gas on the distribution pipeline system to the customer. Transportation service generally refers to a service that a gas utility may provide to larger commercial and industrial customers, including electric generators, where the service rate includes the cost of moving the gas on the distribution pipeline system, but not the pass-through cost of the commodity as these customers purchase the gas commodity directly from gas suppliers and marketers. In states that have authorized retail "unbundling programs," retail customers are allowed, but may not be required to make a choice to purchase gas commodity supplies directly from suppliers rather than from the LDC. In some cases, the LDC acts as the commodity supplier of last resort.

Gas utilities are obligated by public service regulations to reliably meet the natural gas supply needs of their customers at just and reasonable rates, terms and conditions of service. To fulfill this public service obligation, gas utilities develop comprehensive plans and manage assets, operations and contractual portfolios that include physical natural gas supply arrangements, natural gas transportation, and natural gas storage.[14]

Contracts that provide for the firm delivery of a variable quantity of natural gas allow for the sale and delivery of natural gas at the volumes, delivery points and times where the gas utility anticipates such natural gas will be needed.[15] If delivery or receipt is not made as provided for in accordance with the terms of such contracts, absent a force majeure event, the failure to deliver or receive the gas would constitute a breach.[16] These customary commercial arrangements provide natural gas utilities the ability to plan their utility operations to reliably manage their systems throughout the year, including on short notice to unexpected changes in weather, pipeline constraints, operational needs, or customer demand.

The specific resource needs of each gas utility differ depending on the geographic region in which the utility's customers and facilities are located, access to readily available natural gas supply, proximity to interstate pipelines, and the existence or availability of on-system or off-system resources, such as underground natural gas storage and liquefied natural gas supplies. Given the unique factors that influence individual gas utilities' resource needs, the customary operational and commercial arrangements used by gas utilities must be tailored to address each gas utility's specific needs, such as provisions related to maximum and minimum quantities, nomination times, delivery locations, the applicable delivery period, and the number of days in the seasonally-defined delivery period when the volumes can be nominated. However, the underlying purchase and sale of physical natural gas, and the intention of the parties to physically deliver and purchase natural gas as provided for in accordance with the terms of such contracts remains constant.

B. Natural Gas Peaking Supply Contracts Used by Gas Utilities Meet the Characteristics Discussed in Part II.A.2 of the Proposed Guidance

As discussed above, the Proposed Guidance is narrowly limited to certain electric power capacity contracts and certain peaking natural gas supply contracts entered into by electric utilities.[17] Specifically, Part II.A.2 of the Proposed Guidance discusses the guidance applying to "peaking supply

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[14] This portfolio of assets and contracts also includes contracts for "baseload" natural gas commodity purchases (a volume of gas which serves a constant load), spot (day to day) commodity purchases, pipeline transportation, storage and no-notice services, on-system assets such as natural gas storage, liquefied natural gas storage, and propane air storage, and natural gas commodity contracts with volumetric optionality.

[15] These transactions may be documented using a standard form, such as a version of the North American Energy Standards Board (NAESB) "Base Contract for Sale and Purchase of Natural Gas" which contains separate Transaction Confirmation documentation that provides for parties to specify "Firm (Fixed Quantity)," "Firm (Variable Quantity)," and "Interruptible" performance obligations and contract quantity amounts. The transactions discussed in these comments would fall under the NAESB category of "Firm (Variable Quantity)" transactions.

[16] As commonly used and understood in natural gas commodity contracts, the term "firm service" is a performance obligation under which neither party may interrupt performance to the other without liability except in a "force majeure" event. In a similar context, FERC defines "service on a firm basis" for pipeline transportation and storage as a service that is "not subject to a prior claim by another customer or another class of service and receives the same priority as any other class of firm services." *See* 18 C.F.R. § 284.7(a)(3).

[17] *See*, Proposed Guidance, 81 Fed. Reg. at 20584.

contracts" entered into by *electric utilities* (with or without a minimum gas delivery requirement). The Proposed Guidance, however, does not address similar natural gas peaking supply contracts entered into by *natural gas utilities*, which do not supply electricity and do not otherwise fit within the definitions provided in the Proposed Guidance. Further, the Proposed Guidance describes a "peaking supply contract" very narrowly in this context to mean a contract that enables an electric utility to purchase natural gas from another provider on those days when its local natural gas utility curtails its natural gas transportation service.[18] As previously discussed in these comments, this is just one particular example within the category of what can be termed a "peaking supply contract."

AGA submits that the characteristics discussed in Part II.A.2, squarely apply to the natural gas peaking supply contracts that natural gas utilities enter into as part of their public service obligation. The following is a discussion of how such natural gas contracts with variable quantity terms fit the characteristics:

- The contracts are entered into by a commercial market participant.
    - ➢ An LDC, or natural gas utility, is a commercial market participant. Gas utilities regularly take and make deliveries of natural gas in the ordinary course of their operations as merchants of the natural gas commodity purchased to meet the natural gas supply needs of residential, commercial and industrial sales service customers.

- The contracts are not traded on an organized market or OTC.
    - ➢ These natural gas commodity contracts are custom-tailored, in terms of delivery period, delivery point(s), and volumes, to meet the specific needs of individual gas utilities based on unique factors that influence individual gas utilities' resource needs. These contracts are not standardized trading contracts, nor are such contracts traded OTC.

- The contracts do not have severable payment obligations.
    - ➢ These transactions are intended to be settled by physical delivery and purchase of the natural gas as provided for under the terms of the contract. Payment obligations are not severable, and the transactions do not anticipate or permit financial settlement.

- Physical settlement is contemplated or intended, and the transactions are closely tied to the gas utility's regulatory public service requirements, the need to purchase and maintain reliable supplies of natural gas to meet anticipated need, or[19] to manage operational risks, including anticipating weather extremes and potential supply interruptions by taking into account storage or transportation constraints.
    - ➢ Physical settlement by delivery of natural gas is contemplated under these agreements, and the failure to physically deliver or receive by either party, absent force majeure, would be a breach of contract. As previously discussed in these comments, these natural gas commodity agreements are entered into by gas utilities as part of customary commercial operations in response to regulatory public service obligations to serve residential, commercial and industrial customers – this requires gas utilities to plan ahead and stand ready to provide reliable natural gas service to customers utilizing

[18] *Id.* at 20584.
[19] AGA submits that the "and" in this list as described in the Proposed Guidance should be "or" *Id.* at 20586.

agreements that are structured to reflect the individual needs of each gas utility, including the practical considerations of weather, supply, demand, and available transportation and storage.

- The commodity covered by the contract is used by at least one of the parties (the gas utility) as part of normal operation of its business, and the contract is entered into by commercial or non-profit entities as principals to serve an independent commercial, business or non-profit purpose and not for speculative, hedging or investment purposes.
    - ➢ The natural gas commodity covered by these contracts is needed for the normal operation of a natural gas utility's business and such contracts are entered into by the gas utility for its business purpose of providing reliable and reasonably-priced natural gas service and not for speculative, hedging or investment purposes; natural gas utilities typically do not make any profit on the natural gas commodity procured for delivery to their sales service customers.

- In short, these gas supply contracts have substantially similar characteristics as the customary commercial arrangements described in the interpretation in the Products Release[20] that are not considered swaps. Such contracts are entered into by commercial or non-profit entities to assure availability of a commodity – natural gas – not to hedge against financial market risks such as a future change in price for the commodity, or to serve a speculative or investment purpose. Such contracts are used to manage or mitigate commercial risks arising from the gas utility's ongoing operations and public service obligations.

- AGA submits that applying the above characteristics to natural gas peaking supply contracts entered into by gas utilities, important customary commercial agreements for such gas utilities, strongly supports the Commission including such contracts in any final guidance specifically stating that such contracts entered into by gas utilities should not be considered "swaps."

AGA recognizes the recent steps that the Commission has taken to: 1) clarify the seven-part test applicable to forward contracts with embedded volumetric optionality;[21] and 2) reduce the regulatory requirements associated with commodity trade options.[22] These efforts to fine-tune the Commission's rules have gone far to provide greater clarity for parties, including AGA's gas utility members, and to reduce the costs and burdens that they bear when they enter into trade option contracts. AGA commends the Commission for these initiatives.[23]

Nevertheless, there is value to the Proposed Guidance that certain types of contracts are not to be considered "swaps." A party that enters into a contract that is within the scope of such guidance would have legal certainty that its contract is not a "swap;" therefore, the seven-part test need not be applied, and the contract cannot be a trade option. The Proposed Guidance, therefore, represents further beneficial fine-tuning of the rules, which is welcome. Having proposed guidance that certain physical natural gas peaking supply contracts that are entered into by gas utilities not be considered "swaps," would provide the further beneficial fine-tuning and regulatory certainty AGA

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[20] *See*, Section II.B.3 in the Products Release, 77 Fed. Reg. at 48246 (August 13, 2012).
[21] Final Interpretation, Forward Contracts with Embedded Volumetric Optionality, 80 Fed. Reg. 28239 (May 18, 2015) ("Volumetric Optionality Final Interpretation").
[22] Final Rule, Trade Options, 81 Fed. Reg. 14966 (March 21, 2016) ("Trade Option Final Rule").
[23] AGA understands that the Proposed Guidance, if adopted as final, would not have any impact on either the Volumetric Optionality Final Interpretation or the Trade Option Final Rule.

has been seeking for its members. AGA thus respectfully requests that the Commission extend the Proposed Guidance to equivalent natural gas peaking supply contracts with the same characteristics. Equivalent contracts should receive equivalent treatment.[24]

IV. Conclusion

AGA appreciates the Commission's efforts to provide additional clarity regarding the treatment of certain natural gas peaking supply contracts. As stated in these comments, AGA respectfully urges the Commission to extend the Proposed Guidance by including natural gas peaking supply contracts entered into by gas utilities as equivalent types of arrangements that should not be considered swaps in any final guidance. This further clarification would provide greater certainty to gas utilities. AGA appreciates this opportunity to comment and looks forward to the expedient issuance of final guidance that provides the additional clarifications for gas utilities requested herein.

Respectfully submitted,

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cc: Chairman Timothy Massad
Commissioner Sharon Bowen
Commissioner J. Christopher Giancarlo

[24] The Proposed Guidance is based on the joint interpretation set out by the Commission and the Securities and Exchange Commission in the Products Release, 77 Fed. Reg. 48207 (August 13, 2012). The Product Definitions Rulemaking stated that parties to an agreement, contract or transaction may "seek an interpretation from the Commissions as to whether the agreement, contract or transaction is a swap or security-based swap." *Id.* at 48248. As noted above, AGA has asked the Commission on several occasions to clarify that natural gas peaking supply contracts of the type described herein not be considered swaps. Having issued Proposed Guidance that would provide such clarification to a narrowly-limited type of peaking supply contract, any final guidance issued by the Commission should extend that guidance to the equivalent contracts, bearing the same characteristics, for which AGA has previously requested an interpretation and which are described in this letter.