September 30, 2017

Via Electronic Submission

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

Re: Comments of the American Gas Association, CFTC Regulatory Reform – Project KISS, RIN 3038-AE55

Dear Mr. Kirkpatrick:

The American Gas Association submits these comments in response to the Request for Information published in the *Federal Register*[1] seeking public suggestions regarding how the Commodity Futures Trading Commission's ("CFTC") existing rules, regulations, or practices could be applied in a simpler, less burdensome, and less costly manner. This review effort is part of a CFTC agency-wide review called Project KISS ("Keep It Simple Stupid").

AGA supports the CFTC's continued efforts, such as Project KISS, to ensure that the CFTC-regulated markets related to energy commodities function efficiently for the benefit of all market participants, including reducing the burdens on non-financial commercial end-users, such as AGA member natural gas utilities. In particular, AGA's suggestions for the CFTC's consideration in this effort regard reforms in the following areas: 1) ***Natural Gas Peaking Supply Contracts*** – the CFTC's provision of clear guidance that certain physical natural gas peaking supply contracts entered into by gas utilities are not swaps; and 2) ***Administrative Process Reforms*** – specifically, the adoption of certain administrative process reforms that would set forth a clear and streamlined process for stakeholders to request further review and/or clarifications regarding final rules in a timely manner.

I. Communications

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

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[1] 82 Fed. Reg. 23765 (May 24, 2017).

II. Identity and Interests

The American Gas Association, founded in 1918, represents more than 200 state-regulated and municipal natural gas utility companies that deliver clean natural gas to more than 177 million Americans. AGA also advocates for the more than 73 million residential, commercial and industrial natural gas customers in the U.S., of which 95 percent — more than 69 million customers — receive their gas from AGA members. Today, natural gas meets more than one-fourth of the United States' energy needs.[2]

AGA's members enter into commercial risk management transactions in markets regulated by the CFTC. AGA member companies' principal business is to provide natural gas local distribution services to residential, commercial and industrial customers. For state-regulated entities, this distribution service is provided at rates, terms and conditions that are regulated at the local level by a state commission or other regulatory authority with jurisdiction. In many cases, this regards the procurement and provision of the physical natural gas commodity for use by customers in equipment in their homes and businesses, and the distribution of that natural gas commodity on local pipeline systems to such homes and businesses. Additionally, to ensure reasonable rates for the natural gas commodity that is provided to customers, many of AGA's members engage in risk management transactions in markets regulated by the CFTC. Many gas utilities also use a variety of commercial risk hedging tools, such as futures contracts traded on CFTC-regulated exchanges and over-the-counter ("OTC") energy derivatives, to hedge or mitigate the commercial risks associated with providing safe, reliable and cost-effective natural gas service to customers. The activities in which AGA member natural gas utilities engage pose little or no systemic risk to the U.S. financial system.

III. Regulatory Reform Comments

A. AGA Seeks Clear Guidance that Certain Physical Natural Gas Peaking Supply Contracts Entered Into By Natural Gas Utilities Are Not Swaps

The foundation of the CFTC's regulation of the financial derivatives market (other than exchange-traded futures) rests on what is or is not considered a "swap." For example, questions such as – Who is or is not a swap dealer or major swap participant? What transactions are required to be cleared? What transactions are required to be reported? – all rest on the definition of a "swap." However, despite repeated requests by the natural gas industry, and several attempts by the CFTC, the agency has yet to define the parameters of its "swap" definition in a manner that can be clearly and consistently applied within the gas industry to physical natural gas peaking supply contracts.

The development of the "swap" definition as it relates to natural gas market participants has had a long history of proposals, comments, interim final rules, multi-part tests, and follow-up guidance. Specifically, for natural gas peaking supply contracts – key contracts entered into by natural gas utilities as part of their public service obligation to reliably meet the natural gas needs of their residential, commercial and industrial customers – clarity that such transactions are not "swaps" would provide valuable regulatory certainty (and thus "keep it simple stupid") in an area where there has been much needless complexity and confusion.

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

For these transactions that contain some option or choice for one or the other counterparty, questions remain as to whether they would: be considered commodity options regulated as swaps; meet a three-part test and a seven-part test to be excluded from the swap definition as options embedded in forward contracts; be viewed as trade options not currently subject to reporting requirements (but subject to recordkeeping requirements) for commercial end users; or be considered facility use agreements that meet a three-part test and then a five-part test and not subject to regulation at all. Over the past several years, AGA has actively sought clarification that these contracts should not be considered "swaps."[3]

For AGA member regulated utilities, regulatory certainty is essential for business planning and compliance. Given this, as discussed below, there is value to further guidance from the CFTC that clarifies that certain physical natural gas peaking supply contracts are not to be considered "swaps" – namely, 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.

To understand just how necessary and valuable such a clarification would be, a brief history of the efforts to define "swap" and how these efforts have created confusion in the natural gas industry, and hence led to this renewed request for clear guidance, is provided in Section A(1) immediately below. In Section A(2), we then discuss the issue of natural gas peaking supply contracts in particular. And, in Section B, we address certain administrative process reforms that, if adopted by the CFTC, would go a long way towards avoiding the tortured tale described in Section A(1) as the CFTC issues new rules in the future.

1. Background of CFTC Efforts to Define "Swap"

In May 2011, the CFTC issued a proposed rule and proposed interpretations regarding the "swap" definition.[4] There, the CFTC proposed to exclude forward contracts in non-financial commodities from the definition of a "swap" under the Dodd-Frank Act, consistent with its historical interpretation of the forward contract exclusion under the Commodity Exchange Act. The CFTC explained that excluded forward contracts with respect to non-financial commodities are commercial merchandising transactions where the primary purpose is to transfer ownership of the commodity and not to transfer solely the price risk.

The CFTC indicated that the statutory definition of "swap" explicitly provided that commodity options are "swaps." Thus, for non-financial commodity options embedded in forward contracts, the CFTC established a three-part test. The CFTC explained that a transaction will be considered an excluded forward contract (and not a swap) where the non-financial embedded option: (1) may be used to adjust the forward contract price, but does not undermine the overall nature of the contract as a forward contract; (2) does not target the delivery term, so that the

[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).

[4] *Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 76 Fed. Reg. 29,818 (May 23, 2011) ("Products Definition NOPR").

predominant feature of the contract is actual delivery; and (3) cannot be severed and marketed separately from the overall forward contract in which it is embedded. The CFTC stated that where the embedded option renders delivery optional, the predominant feature of the contract cannot be actual delivery, and the embedded option to not deliver precludes treatment of the contract as an excluded forward contract. The CFTC sought public comment on all aspects of its proposed definitions and interpretations.

The CFTC's proposed rule and interpretations generated considerable confusion in the natural gas industry as market participants began to wonder whether their commercial merchandising transactions with flexible delivery terms would be considered "swaps" under the CFTC's proposed interpretation. Numerous comments were filed seeking clarification as to whether particular types of transactions would be considered "swaps." AGA's comments explained that gas utilities enter into physical gas supply transactions with flexible delivery terms as important elements of their ability to meet their customers' needs at a reasonable cost. Because gas consumption to residential and commercial customers is largely weather-driven (consumption increases as the weather gets colder) and predicting the weather is not an exact science, gas supply contracts with delivery flexibility help AGA members make sure gas supplies are, or can be made, available when the customers actually need the gas without having to pay excessively higher prices at the actual time of need and/or other fees associated with pipeline imbalance penalties.

In August 2012, almost two years later, the CFTC issued an interim final rule, further interpretations, and a request for comment on the interpretations providing additional guidance on the scope of its forward contract exclusion.[5] In particular, the CFTC established a seven-part test that it would apply in determining whether a contract with flexible delivery terms would be regulated as a "swap" or excluded as a forward contract. The CFTC then provided further interpretations responding to the requests to clarify whether certain types of transactions would be considered, and regulated as, "swaps." Notably, the CFTC attempted to clarify that certain physical commercial transactions for natural gas pipeline transportation and storage service agreements would not be considered options, and thus would not be regulated as "swaps," if they met a three-part test. However, the CFTC added that if such transportation and storage agreements employed a certain two-part rate structure, such agreements would be considered options subject to swap regulation.

The interpretations, however, created more confusion than they clarified for the industry. How should the seven-part test be applied? What do some of the elements mean? Did the CFTC really intend to regulate as "swaps" all natural gas pipeline transportation and storage agreements with two-part rates? Numerous comments were filed seeking clarification of the CFTC's rules and interpretations. Many comments focused on whether pipeline transportation and storage agreements, long regulated exclusively by the Federal Energy Regulatory Commission (FERC) under the Natural Gas Act, would be considered options and subject to the CFTC's swap regulations. In November 2012, the CFTC's Office of General Counsel (OGC) issued a Response to Frequently Asked Questions Regarding Certain Physical Commercial Agreements for the Supply and Consumption of Energy. OGC staff stated that if a pipeline transportation or storage agreement

[5] *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48,208 (Aug. 13, 2012) ("Further Definitions Final Rule").

with a two-part rate structure met an additional five-part test, the transaction would not be considered an option and thus would not be subject to regulation as a "swap."

Relatedly, in April 2012, the CFTC issued an interim final rule holding that certain commodity options would be considered "trade options" if they met a three-part test.[6] Trade options, while regulated by the CFTC, would not be subject to the full panoply of regulations established for "swaps." In particular, trade options would be subject to significantly less intense reporting requirements for counterparties that are not already required to report their swaps. Once again, several comments were filed in response to the interim final rule. CFTC staff subsequently issued no-action relief regarding trade option reporting.

In an effort to address the substantial confusion within the gas industry related to contracts with embedded optionality, on November 13, 2014, the CFTC issued a new proposed interpretation that sought to clarify the CFTC's interpretation regarding forwards with embedded volumetric optionality that was set forth in the interim final rule on definitions that had been adopted in 2012.[7] The Proposed Interpretation carried forward the seven-part test of determining whether a transaction falls within the forward exclusion from the "swap" definition, notwithstanding that it contains embedded volumetric optionality, but modified the seventh element to clarify that its focus is intent with respect to the embedded volumetric optionality at the time the contract is initiated (and not when the option is exercised).

On May 12, 2015, the CFTC issued its final interpretation concerning forward contracts with embedded volumetric optionality,[8] which largely followed the Proposed Interpretation. But significantly with respect to natural gas peaking supply contracts, neither the Proposed Interpretation nor the Final Interpretation changed the requirement of the seven-part test that a non-nominal amount of commodity must be delivered under a contract in order for it to be considered a forward contract. Therefore, with respect to commonly used peaking supply natural gas contracts that do not have a firm delivery requirement (e.g., these contracts typically permit a party to call upon an amount ranging from zero "up to" a certain maximum quantity of natural gas during any day during the term), such contracts would not appear to pass the test, notwithstanding the helpful clarifications that were made to the seventh element. While parties could classify these contracts as trade options, again, the industry's request for clear regulatory certainty was left unfulfilled.

Approximately a year later, on March 16, 2016, the CFTC issued a final rule to amend the trade options exemption by deleting the reporting requirements for trade option counterparties that are not swap dealers (SDs) or major swap participants (MSPs), and deleting the existing Form TO reporting requirement that commercial end-users such as AGA members had to file annually in connection with otherwise unreported trade options.[9] The CFTC explained that the proposal was intended to reduce reporting burdens for Non-SD/MSP trade option counterparties. The CFTC noted AGA's comment that the proposed elimination of Form TO could reduce a significant compliance cost and obviate the need for small end-users to track and report their trade options

[6] *Commodity Options*, 77 Fed. Reg. 25,320 (April 27, 2012).
[7] *Forward Contracts With Embedded Volumetric Optionality*, 79 Fed. Reg. 69,073 (Nov. 20, 2014) ("Proposed Interpretation").
[8] *Forward Contracts With Embedded Volumetric Optionality*, 80 Fed. Reg. 28,239 (May 18, 2015) ("Final Interpretation").
[9] *Trade Options*, 81 Fed. Reg. 14,966 (March 21, 2016).

activity for a given calendar year, and recognized that completing Form TO imposes costs and burdens on Non-SDs/MSPs who enter into trade options, especially small end-users. AGA commended the CFTC for this final rule representing efforts to fine-tune certain rules to provide greater clarity for stakeholders, including AGA's gas utility members, and particularly to reduce the costs and burdens that parties bear when they enter into trade option contracts.

2. AGA Members Still Face Regulatory Uncertainty Regarding Natural Gas Peaking Supply Contracts

Notwithstanding all the definitions, interpretations, proposals, guidance, clarifications, and multi-part tests noted above, AGA's members still suffer from regulatory uncertainty regarding natural gas peaking supply contracts, which AGA has been seeking for over five years. To be sure, in April 2016, the CFTC issued another proposed guidance document that addressed whether certain natural gas contracts which are entered into by electric utilities,[10] with or without a minimum gas delivery requirement, should be regulated as swaps.[11] Although this proposed guidance presented an opportunity for the CFTC to address the natural gas utility industry's request for clear guidance on peaking supply contracts, unfortunately, that requested clarification remains unaddressed today.

Specifically, the natural gas contracts described in the Proposed Guidance were entered into by a cogeneration facility (with or without a minimum gas delivery requirement). The CFTC stated that the Proposed Guidance only applies to these contracts, which the CFTC preliminarily concluded should be considered not to be swaps because they are customary commercial arrangements.

AGA filed comments on the Proposed Guidance on May 9, 2016,[12] noting that it represented a welcome effort by the CFTC in terms of providing regulatory certainty of the type that the natural gas utility industry had been requesting. AGA observed that the Proposed Guidance was too limited to be useful for AGA members, but stated that the Proposed Guidance outlined an approach that should be extended to provide the additional guidance that AGA has been requesting for natural gas peaking supply contracts. AGA requested that the CFTC extend the Proposed Guidance to provide additional certainty to natural gas utilities by confirming that any final guidance applies to equivalent natural gas peaking supply contracts entered into by natural gas utilities. AGA's comments described in detail how these contracts aligned with the characteristics of the contracts that were addressed in the Proposed Guidance, and why they should not be considered "swaps" for the same reasons discussed in the Proposed Guidance as to the specific contracts discussed therein.

AGA's request that the CFTC finalize the Proposed Guidance, and extend its regulatory certainty to natural gas peaking supply contracts entered into by natural gas utilities as well, was made almost a year and a half ago, but has not yet been answered. Accordingly, AGA urges the CFTC, as part of the Project KISS regulatory reform effort, to address the request that AGA made on May 9, 2016. This request is consistent with the objective of Project KISS because it provides

[10] Note, in the specific facts provided, the entity was a cogeneration facility, not an electric utility.
[11] *Proposed Guidance, Certain Natural Gas and Electric Power Contracts*, 81 Fed. Reg. 20583 (April 8, 2016) ("Proposed Guidance").
[12] *See* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60799&SearchText=

the CFTC with an opportunity to reduce regulatory compliance costs by addressing in a clear manner this well-documented uncertainty in the natural gas industry with respect to commonly used physical natural gas peaking supply contracts.

AGA members seek clarification that such transactions are not considered "swaps" in order to remove the burdensome application of a multi-part test that could leave parties subject to the risk that the CFTC subsequently disagrees with their application of the test in a CFTC audit and/or enforcement proceeding. As regulated entities, gas utilities know how to comply with regulations – all they seek is regulatory certainty so they can make good faith and well-informed plans for regulatory compliance.

B. Administrative Process Reforms

As demonstrated by the efforts discussed in the Section 1 above to clearly define what is a "swap," and the natural gas industry's efforts discussed in Section 2 above to obtain clarification of the classification of natural gas peaking supply contracts, AGA and its members have been frustrated in their efforts to obtain regulatory certainty from the CFTC in its implementation of the Dodd-Frank Act. Uncertainty regarding a definition so fundamental to derivatives regulation as what is and what is not a "swap," and regarding the regulatory treatment of contracts as critical and as common as natural gas peaking supply contracts, has hampered business and compliance planning and disrupted contracting practices in the industry along the way. AGA submits that the uncertainty has also hampered the CFTC's ability to be an effective market monitor and regulator. As stated previously in other forums, AGA believes that the CFTC and the industry would benefit greatly from the CFTC's adoption of additional administrative processes whereby stakeholders could obtain in a timely manner the kind of regulatory certainty they need for business planning and compliance, and could challenge agency action, if necessary. In particular, AGA recommends that the CFTC adopt internal processes to allow for requests for clarification and/or rehearing, as are commonly pursued at FERC with respect to final orders.[13]

Currently, there are no avenues available for the public to obtain timely, definitive guidance regarding final agency action by the CFTC. This is particularly problematic as to the impacts of the CFTC's regulations on commercial end-users. Consequently, parties have relied on staff action in the form of no-action or exemptive relief, interpretive guidance, and/or interpretations by the OGC to obtain necessary clarifications of the CFTC's rules. These avenues are less than satisfying in that, as illustrated by the history recounted above, they reflect only the views of staff and not those of the CFTC commissioners themselves, and may address only the part of an issue that affects the office or division granting relief. The CFTC should provide commercial market participants with specified administrative processes in which to obtain definitive and complete guidance from the agency concerning the meaning of its rules on a timely basis.

The process at FERC provides a well-used real world agency example of a way for stakeholders to request clarification and/or rehearing of FERC's final orders prior to pursuit of what could be a time-consuming and costly court action. This avenue has proven extremely useful to stakeholders as a means to raise issues that may not have been at the top of the agency's mind in putting together the final rule and/or in providing clarifications as to how a new rule co-exists with existing rules and/or regulations. The ability to request clarifications can be beneficial to the CFTC

[13] *See* Section 19 of the Natural Gas Act (15 USC § 717r).

as well because it would enable the CFTC to provide its own follow up on items it may not have addressed fully in a final rule, and/or the opportunity to provide additional clarification to stakeholders on issues of importance to their business and rule compliance. This is particularly important for entities, such as non-financial commercial end-users that may not be the main subject of a CFTC rule, but which nonetheless may be impacted by, and/or need to know and understand how to comply with and/or whether or not they are exempted from, that final rule.

A process to request clarification and/or rehearing would benefit stakeholders in terms of time and costs of litigation. In many cases, the agency may have an answer to the request and thus it is only administratively efficient to allow it to respond to follow up questions. Additionally, the process would be able to occur within a specified time period following the issuance of a final rule and thus stakeholders would not be left hanging with questions for an extended period of time and/or forced to rely on a no-action letter that may expire (as has repeatedly happened to AGA members during the CFTC's implementation of the Dodd-Frank Act). Additionally, allowing for a time period for rehearing and/or clarification also may allow for the agency and stakeholders to communicate without having to resort to the time and expense of litigation.

Although FERC's process was established by statute, AGA sees no reason why the CFTC could not adopt such a process through the exercise of its authority under the Commodity Exchange Act ("CEA").[14] AGA would welcome the opportunity to work with the CFTC and other interested stakeholders to develop such a process.

IV. Conclusion

AGA commends the CFTC for its regulatory reform efforts in the Project KISS initiative, and appreciates the opportunity to provide these comments. AGA's recommendations are made with the goal that existing CFTC rules, regulations, and practices can be applied in a simpler, more clear, less burdensome, and less costly manner with a particular focus on some long standing issues which, if addressed, would reduce the burdens on stakeholders, including non-financial commercial end-users, such as AGA member natural gas utilities.

Respectfully submitted,

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[14] *See* CEA Section 8a(5), 7 U.S.C. 12a(5) (CFTC is authorized "to make and promulgate such rules and regulations as, in the judgment of the [CFTC], are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of [the CEA]").