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ON BEHALF OF THE AMERICAN PUBLIC GAS ASSOCIATION

BEFORE THE COMMODITY FUTURES TRADING COMMISSION

JULY 28, 2009

Chairman Gensler and Commissioners of the Commodity Futures Trading Commission ("Commission"), I appreciate this opportunity to testify before you today and I thank the Commission for calling this hearing to examine the critically important issues of position limits in energy contracts. My name is Laura Campbell and I am the Assistant Manager of Energy Resources for Memphis Light Gas & Water (MLGW). MLGW is the nation's largest three-service municipal utility and currently provides service to more than 420,000 customers. Since 1939, MLGW has met the utility needs of Memphis, Tennessee and Shelby County residents by delivering reliable and affordable electricity, natural gas and water service. Natural gas is the most popular means of residential heating in the MLGW service area and we currently provide natural gas to more than 313,000 customers.

I testify today on behalf of the American Public Gas Association (APGA). APGA is the national association for publicly-owned natural gas distribution systems. There are approximately 1,000 public gas systems in 36 states and over 720 of these systems are APGA members. Publicly-owned gas systems are not-for-profit, retail distribution entities owned by, and accountable to, the citizens they serve. They include municipal gas distribution systems (like MLGW), public utility districts, county districts, and other public agencies that have natural gas distribution facilities.

The market for natural gas financial contracts is composed of a number of segments. Among APGA's members are active participants in all segments of the market for natural gas. For example, public gas systems depend upon the physical commodity markets in natural gas to source their supplies. Often, these contracts are long-term natural gas supply contracts at prevailing market prices. Many members are also market participants in the exchange-traded or over-the-counter ("OTC") derivatives markets. Together, these markets play a critical role in these utilities securing natural gas supplies at stable prices for their communities.

In order to hedge their price exposure, our members may be active in any (or all) of the exchange-traded or OTC market segments. Contracts for the future delivery of natural gas are traded on the New York Mercantile Exchange ("NYMEX"), a designated contract market regulated by the Commission. Contracts for natural gas are also traded in the OTC markets. OTC contracts may be traded on multi-lateral electronic trading facilities which are exempt from regulation as exchanges ("exempt commercial markets" or "ECMs"). They may also be traded in direct, bi-lateral transactions between counterparties, through voice brokers or on electronic platforms.

Financially-settled OTC contracts in natural gas often are settled based upon NYMEX settlement prices and physically delivered OTC contracts may draw upon the same deliverable supplies as NYMEX contracts, thus economically linking the various financial natural gas market segments, including regulated futures markets, ECMs and bilateral trading, whether conducted on an electronic trading platform or otherwise.

For this reason, APGA has pushed for the passage of legislation and regulations that increase transparency and help ensure that the OTC markets are an accurate reflection of supply and demand conditions for natural gas. Specifically, APGA supported enactment of the CFTC Reauthorization Act of 2008 ("Reauthorization Act") and, in particular, the provisions of the Reauthorization Act which significantly expanded the Commission's oversight authority with respect to exempt commercial markets having Significant Price Discovery Contracts ("SPDC").[1] APGA has also supported increases in funding for the Commission to ensure that it has the resources needed to provide an appropriate level of protection for consumers.

Speculators' Effect on the Natural Gas Market

As hedgers that use both the regulated futures markets and the OTC energy markets, our members value the role of speculators in the markets. We also value the different needs served by the regulated futures markets and the more tailored OTC markets. As hedgers, public gas systems depend upon liquid and deep markets in which to lay off our risk. Speculators are the grease that provides liquidity and depth to the markets.

However, speculative trading strategies may not always have a benign effect on the markets. For example, the dramatic blow-up of Amaranth Advisors LLC and the impact it had upon prices exemplifies the adverse impact that speculative trading interests can have on natural gas supply contracts for local distribution companies ("LDCs"). Amaranth Advisors LLC was a hedge fund based in Greenwich, Connecticut, with over $9.2 billion under management. Although Amaranth classified itself as a diversified multi-strategy fund, the majority of its market exposure and risk was held by a single Amaranth trader in the OTC derivatives market for natural gas.

[1] The Commission recently published in the Federal Register its "Notice of Intent to Undertake a Determination Whether the Henry Financial LD1 Fixed Price Contract Traded on the Intercontinental Exchange, Inc., Performs a Significant Price Discovery Function," 74 *Fed. Reg*. 28028 (June 12, 2009). This notice requested commenters to provide written views, data and analysis that would address whether the Intercontinental Commodity Exchange Henry Financial LD1 Fixed Price Contract for natural gas ("ICE Henry Hub Contract") is a Significant Price Discovery Contract ("SPDC"). APGA submitted its views and analysis supporting a determination that the ICE Henry Hub Contract is a SPDC.

Amaranth reportedly accumulated excessively large long positions and complex spread strategies far into the future. Amaranth's speculative trading wagered that the relative relationship in the price of natural gas between summer and winter months would change as a result of shortages which might develop in the future and a limited amount of storage capacity. Because natural gas cannot be readily transported about the globe to offset local shortages, the way for example oil can be, the market for natural gas is particularly susceptible to localized supply and demand imbalances.[2] The Report by the Senate Permanent Committee on Investigations affirmed that "Amaranth's massive trading distorted natural gas prices and increased price volatility."[3] APGA believes that these price distortions directly increased the cost of natural gas for many of our member's customer rate payers.[4]

Recently, additional concerns have been raised with respect to the size of positions related to, and the role of, passively managed long-only index funds. In this instance, the concern is not whether the positions are being taken in order to intentionally drive the price higher, but rather whether the unintended effect of the cumulative size of these positions has been to push market prices higher than the fundamental supply and demand situation would justify. Similarly, investment instruments which overlie contracts on natural gas may also be traded on securities exchanges through Exchange Traded Funds or issues of Exchange Traded Notes.

The additional concern has been raised that recent increased amounts of speculative investment in the futures markets generally have resulted in excessively large speculative positions being taken that due merely to their size, and not based on any intent of the traders, are putting upward pressure on prices. The argument made is that these additional inflows of speculative capital are creating greater demand then the market can absorb, thereby increasing buy-side pressure which results in advancing prices.

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[2] Amaranth's strategy was reportedly based upon a presumption that hurricanes during the summer of 2006 would make natural gas more expensive in 2007, similar to the impact that hurricanes Katrina and Rita had had on prices the previous year. As reported in the press, Amaranth held open positions to buy or sell tens of billions of dollars of natural gas. As the hurricane season proceeded with very little activity, the price of natural gas declined, and Amaranth lost approximately $6 billion, most of it during a single week in September 2006. The unwinding of these excessively large positions and that of another previously failed $430 million hedge fund—MotherRock— further contributed to the extreme volatility in the price of natural gas.

[3] *See "Excessive Speculation in the Natural Gas Market,"* Report of the U.S. Senate Permanent Subcommittee on Investigations (June 25, 2007) ("PSI Report") at p. 119

[4] Many natural gas distributors locked in prices prior to the period Amaranth collapsed at prices that were elevated due to the accumulation of Amaranth's positions. They did so because of their hedging procedures which require that they hedge part of their winter natural gas in the spring and summer. Accordingly, even though natural gas prices were high at that time, it would have been irresponsible (and contrary to their hedging policies) to not hedge a portion of their winter gas in the hope that prices would eventually drop. Thus, the elevated prices which were a result of the excess speculation in the market by Amaranth and others had a significant impact on the price these APGA members, and ultimately their customers, paid for natural gas. The lack of transparency with respect to this trading activity, much of which took place in the OTC markets, and the extreme price swings surrounding the collapse of Amaranth have caused bona fide hedgers to become reluctant to participate in the markets for fear of locking-in prices that may be artificial.

APGA commends the Commission for its focus on the possible impact speculative investment has on the price of natural gas and other energy commodities, for asking these tough questions, and for holding these hearings to gather views on whether speculative position limits should be applied to energy contracts. APGA notes that in considering the issue of the application of speculative position limits to energy contracts, policy makers should not lose sight of the significant history and experience that surrounds the use of speculative position limits as a regulatory tool.

History of Regulation Under the Commodity Exchange Act

Systemized trading in contracts for the future delivery of agricultural commodities developed in the United States in the mid to late 1800s from an economic need for risk shifting. Glaring abuses were attendant with the advantages of trading, these included price manipulations, market corners and extreme and sudden price fluctuations on the organized exchanges. These abuses stirred repeated demands for legislative action to prohibit or comprehensively regulate futures trading. Although the first regulation of the grain futures markets dates from the 1920's,[5] the Commodity Exchange Act of 1936[6] was the first statute to comprehensively regulate the futures markets.

Section 3 of the Act as it existed before the 2000 amendments explained the statute's purpose in relevant part as follows:

> Transactions in commodities involving the sale thereof for future delivery as commonly conducted on boards of trade and known as "futures" are affected with a national public interest. Such futures transactions are carried on in large volume by the public generally and by persons engaged in the business of buying and selling commodities and the products and byproducts thereof. . . . The prices involved in such transactions are generally quoted and disseminated through the United States and in foreign countries as a basis for determining the prices to the producer and the consumer. . . .The transactions and prices of commodities on such boards of trade are susceptible to excessive speculation and can be manipulated, controlled, cornered or squeezed, to the detriment of the producer or the consumer. . . .

Section 4a(a) of the Act echoes the Congressional finding of former section 3, providing that, "Excessive speculation in any commodity under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets . . . causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity." 7 U.S.C. §6a.

The CFTC in 1981 adopted a rule requiring all futures exchanges to impose speculative position limits for all commodities that were not subject to a Federal

[5] See, Grain Futures Act of 1922, Publ. L. No. 6-331, 42 Stat. 998 (1922).
[6] Act of June 15, 1936, ch 545 §5, 49 Stat 1494.

speculative position limit.[7] In so doing, the Commission explained the danger that unchecked speculative positions can pose to the markets, saying:

> It appears that the capacity of any contract market to absorb the establishment and liquidation of large speculative positions in an orderly manner is related to the relative size of such positions, i.e., the capacity of the market is not unlimited. Recent events in the silver market would support a finding that the capacity of a liquid futures market to absorb large speculative positions is not unlimited, notwithstanding mitigating characteristics of the underlying cash market.

"Establishment of Speculative Position Limits," 46 *Fed Reg.* 50938, 509040 (October 16, 1981).

Subsequently, the Commission permitted a number of contracts to be exempt from the requirement that the exchange impose a speculative position limit, permitting instead that the exchange impose a "position accountability rule."[8] These exemptions were based on the liquidity of the futures and cash markets for such commodities. Tangible commodities, such as energy, were permitted to have a position accountability rule only for the back months; spot month speculative position limits were still required. The position accountability exemptions were codified by the Commission at 17 C.F.R. §150.5(e).

Finally, Section 13201 of the Reauthorization Act provides that various core principles shall apply to exempt commercial markets on which SPDCs are traded. Core Principle IV requires such an electronic trading facility to adopt position limitations or position accountability for speculators in SPDCs, taking into account positions in other agreements, contacts, and transactions that are treated by a derivatives clearing organization as fungible with such SPDCs.

With that history in mind, APGA is pleased to offer its views on the following specific issues raised by the Commission in its announcement of this hearing.[9]

Issues Under Consideration by the Commission

Applying position limits consistently across all markets and participants.

The determination of whether to apply position limits consistently across all markets and participants is perhaps the single most important issue for the energy market. As we noted above, the various market segments for energy contracts are economically linked, and actions in one market segment can affect prices in the other segments. Recent

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[7] The Commission subsequently modified this requirement, permitting contract markets to impose "position accountability rules" in lieu of speculative position limits for certain contracts, including the energy contracts.

[8] See "Revision of Federal Speculative Position Limits and Associated Rules," 63 *Fed. Reg*. 38525 (July 17, 1998) for an explanation of the position accountability exemptions.

[9] See CFTC Release: 5681-09 (July 21, 2009).

events in the economically linked markets for natural gas have shown the danger of traders being able to move positions from one market to another in order to evade application of a market's position accountability rule or position limit.[10] A unified limit administered by the Commission across all markets, in addition to the limits adopted and administered by each separate market would effectively address this issue and provide an effective and meaningful limitation on the total size of positions that a trader could amass in the delivery month.

APGA strongly supports the use of spot month speculative position limits as a proven and effective tool for addressing markets with constrained deliverable supplies, which is typical of the markets for natural gas. The Commission recently promulgated rules implementing the Reauthorization Act's provisions with respect to the oversight of SPDCs.[11] APGA believes that the final rules are a very good foundation for addressing the issue, but recommends that the Commission consider taking additional steps to strengthen the effectiveness of this important regulatory tool.

In this regard, APGA notes that the Commission deferred action to make spot month speculative position limits or back month position accountability rules apply to both cleared and non-cleared transactions on a market that operates as a SPDC. Despite recognition of the important role that non-cleared transactions play in price formation, the speculative position limits that the Commission's rules require apply only to cleared transactions and do not require that non-cleared transactions be included in calculating whether a trader has violated a spot month speculative position limit. This clearly and inexplicably weakens the prophylactic protection that spot month speculative position limits are intended to provide. Accordingly, APGA suggests that the Commission take this opportunity to include linked, non-cleared SPDCs within the speculative position limit requirement.

APGA also recommends that the Commission reconsider its recent rulemaking and require an exempt commercial market in setting and enforcing spot month limits to account for a trader's positions that may be held on another registered entity in economically-related SPDCs. Unless such an approach is taken, speculative position limits will be far less effective than they otherwise could be, enabling a trader to amass a far larger speculative position in the spot month by dividing its position among several markets or market segments for SPDCs.

APGA also recommended in its comments on the Commission's recent rulemaking, and renews its recommendation to the Commission at this Hearing, for the Commission to adopt its own speculative position limits, particularly in the spot-month, for economically-related SPDCs that are traded on more than one registered entity. By adopting Commission-set speculative position limits, the Commission would be able to aggregate positions across markets and enforce unified position limits, thus preventing a

[10] *See "Excessive Speculation in the Natural Gas Market,"* Report of the U.S. Senate Permanent Subcommittee on Investigations (June 25, 2007) ("PSI Report").
[11] "Significant Price Discovery Contracts on Exempt Commercial Markets; Final Rule," 74 *Fed. Reg*. 12178 (March 23, 3009).

trader from amassing unduly large positions in the spot month by entering positions in economically equivalent SPDCs on different markets or by trading a combination of cleared and uncleared transactions on the same market.

APGA also considers it vitally important that the Commission consider including within such unified speculative positions limits contracts that are traded and maintained OTC. Where such contracts are economically linked to contracts traded on exchange traded or exempt commercial markets, such OTC contracts may have an important influence on pricing and on the performance of other market segments.

In light of the interconnectedness of SPDC contracts traded on different registered entities (and those related contracts traded OTC), a dual system of Commission and market speculative position limits would be a far more effective regulatory tool than reliance only upon market-imposed speculative position limits. Such a dual system is not new; it has existed as part of the regulatory landscape since enactment of the Commodity Exchange Act in 1936.[12] The Commission traditionally has established its own speculative position limits for agricultural commodities, which like natural gas, have limited deliverable supplies. Moreover, the Reauthorization Act specifically provides the Commission with authority to establish Commission set-speculative position limits for SPDCs.[13]

Nor would Commission-set speculative position limits for SPDCs impose undue hardship for traders. Each trader would be free to trade up to the limit at a single market or to break up its position among, or net its position across, markets listing economically linked SPDC contracts.[14]

Recent events in the economically linked markets for natural gas have shown the danger of traders being able to move positions from one market to another in order to evade application of a market's position accountability rule or position limit.[15] A unified limit administered by the Commission across all markets (including OTC transactions), in addition to the limits adopted and administered by each separate market would effectively address this issue and provide an effective and meaningful limitation on the total size of positions that a trader could amass in the delivery month.

However, it should also be noted that position limits should apply to speculative traders and not hedgers. By virtue of being hedgers, such traders tend to have an over-all market-neutral position—that is, the size of their derivatives positions is off-set by their

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[12] See 17 C.F.R. Part 150 for the Commission's rules which establish a dual system of Commission and exchange-set speculative position limits for certain commodities.
[13] *See*, section 13203 (g) of the Reauthorization Act.
[14] This in essence would operate the same as the single month, all months combined limit which enables a trader at the limit to concentrate all positions in one month or break them up across months. A trader could be at the limit at a single market and also hold off-setting positions at another market without violating the limit. No, or minimal, changes in reporting systems would be required; the Commission could rely for the most part on reports that are currently required to be filed by the markets or by their clearing members.
[15] *See "Excessive Speculation in the Natural Gas Market,"* Report of the U.S. Senate Permanent Subcommittee on Investigations (June 25, 2007) .

cash market positions. Moreover, the overall size of their derivatives positions is naturally bounded by their cash market position and hence not subject to the type of over-leveraging displayed by Amaranth and other speculative traders.

With regard to the classification of traders as hedgers or speculators, APGA believes that the ultimate characterization of the position should reflect the nature of the counterparty, (i.e., commercial market end-user ("hedger") and speculative market end-user ("speculator"). Accordingly, contracts that are entered into by a swaps dealer as counterparty to a commercial market end-user would be denominated as "hedging" contracts because the swaps dealer is facilitating the commercial market end-user's hedging transactions. In this way, those of our members who choose to trade OTC will be able to enter into hedging transactions regardless of whether the transaction is OTC or on-exchange. As a corollary, transactions by a swaps dealer with a speculative market end-user in support of a speculative investment , would be categorized as speculative and would be subject to speculative position limits. This would prevent a single speculative end user from transforming speculative positions into hedge positions through the use of an OTC counterparty.

Whether the CFTC needs additional authority to implement such limits

The Commission has the authority and ability to promulgate rules that would provide more effective speculative position limits than it has exercised. As noted above, the Commission has left open the issue of requiring exempt commercial markets to apply a unified speculative position limit to both cleared and non-cleared SPDCs. Moreover, the Commission has authority to establish a dual system of Commission and market-based speculative position limits as has been the model for the enumerated agricultural commodities. Finally, APGA supports the inclusion within a unified speculative position limit of all transactions in economically linked contracts regardless of whether they are conducted on an electronic trading facility, through voice brokerage or bi-laterally. To the extent that the Commission concludes that clarification of its authority to apply a unified limit to all such transactions is necessary, APGA would support the Commission in any request to the Congress for such legislative clarification.

What methodology the Commission should use to determine position limit levels for each market.

The Commission has a long history of, and experience in, establishing speculative position limits. These guidelines are set forth in 17 C.F.R. §150.5. The inclusion of bi-lateral OTC transactions within Commission speculative position limits may present new issues; however, the basic approach developed by the Commission over the years should nevertheless provide guidance in setting such limits. Establishing a dynamic limit based upon percentage of open interest would not be efficacious. The problem with a dynamic level based on open interest is that during the period leading up to contract expiration, a trader might find him or herself going into and out of compliance depending on the relative speed with which others liquidate positions from day to day. Such a trader would have no way of knowing in advance if it would be in compliance with a dynamic position limit. This uncertainty might cause liquidations to be less, rather than more, orderly.

APGA believes that the same methodology for setting speculative positions limits may not be appropriate for every commodity. For example, because deliverable supplies for natural gas are subject to unique constraints, APGA believes that the Commission and stakeholders should explore whether both the spot month and back month speculative position limits should be set with reference to a reasonable percentage of deliverable natural gas supply. We believe that this type of technical analysis should be a focus of the Commission's Energy Advisory Committee.

Should exemptions from position limits be permitted for anyone other than bona fide hedgers for the conduct and management of a commercial enterprise?

APGA believes that certain types of risk management and risk reducing transactions should be treated as though they constitute hedging positions for purposes of speculative position limits. The Commission previously examined this issue and proposed additional exemptions which it permitted exchanges to adopt for risk management, spread and arbitrage transactions. These exemptions appear to be equally sound today and should be permitted.

However, the Commission should be cautious in redefining "bona fide hedging." Although "bona fide hedging" as defined under 17 C.RF.R. §1.3(z) only has applicability for the Commission with respect to its rules relating to speculative position limits, there may be a number of instances where regulators or others rely on the definition for various purposes. For example, certain corporations or municipal government entities may be authorized to trade only for the purpose of "bona fide hedging." Some APGA members operate under such a limitation. The meaning of "bona fide hedging" is well established and conveys a type of use of the markets which is well understood in economic literature. Accordingly, amending the meaning of "bona fide hedging" might have significant unintended consequences by creating uncertainty where none now exists. To the extent that additional trading strategies are determined by the Commission to merit exemption from speculative position limits, the Commission should seek to permit such strategies without obfuscating the defined meaning of "bona fide hedging transaction."

APGA Supports the Continued Availability of Individually Negotiated, Non-cleared OTC Transactions

APGA applauds the Commission for holding these hearings and asking these far-reaching questions, which may have significant ramifications on how well the markets in natural gas operate in the future. APGA has for many years supported greater transparency and oversight with respect to all segments of the market for natural gas, including all segments of the markets for financially-settled OTC derivatives on natural gas. However, APGA's members also believe that the continued availability of bi-lateral, non-cleared OTC derivatives transactions is vital to their being able to provide natural gas to their customers at stable prices and at the lowest possible cost.

Although APGA has been a strong supporter of increasing transparency and market oversight, proposals that would require public gas systems to clear their OTC derivatives transactions would have a significant detrimental impact upon the financial operations of these systems, ultimately increasing the cost to the consumer.

As discussed above, public gas systems depend upon both the physical commodity markets as well as the markets in OTC derivatives to meet the natural gas needs of their consumers. Together, these markets play a critical role in these utilities securing natural gas supplies at stable prices for their communities. Specifically, natural gas distributors purchase firm supplies in the physical delivery market at prevailing market prices, and enter into OTC derivative agreements customized to meet their specific needs, thus reducing their consumers' exposure to future market price fluctuations and stabilizing rates. By using both markets, these public gas systems are able to purchase firm deliveries of natural gas from a diverse set of suppliers while hedging the risk of future market price fluctuations.

However, proposals within the administration and Congress that would require all standardized OTC derivatives transactions to be cleared would significantly impair the financial ability of public gas systems to engage in these gas supply strategies. The mandated clearing of all OTC transactions would require public gas systems to post initial margin and to meet potential margin calls whenever required on little notice. This would constitute a significant financial and operational burden on these systems, their communities and their consumers.

Because many of our members under an OTC Credit Support Annex may have sizable thresholds before collateral on their OTC contracts is required to be posted, requiring the posting of initial margin associated with clearing the same contracts, would significantly increase the cost of carrying such positions to a public gas system. Utilities, such as our members, enjoy these high credit thresholds before collateral is required to be posted based on the strength of their credit ratings and because their counterparties recognize that the hedges executed by public gas systems through OTC swaps are part of the gas systems' cost of gas, which is recoverable from their customers through existing rates. For the public gas system that holds 5,000 contracts, the cost of posting margin on cleared contracts might be as high as requiring the posting of $25 million in margin when no collateral would have been required under their bi-lateral Credit Support Annex. Further postings of maintenance and variation margins are also required for exchange traded clearing and, depending on market moves and timing, can be multiples of the initial margin requirement. Because of their non-profit structure, posting such large amounts of collateral would pose a significant challenge and cost to our members and their consumers.

Another result of mandatory clearing on public gas systems would be the de facto elimination of the use of tax-exempt financing for the prepayment of long-term natural gas contracts, also known as “prepays.” Prepays were endorsed by Congress as part of the Energy Policy Act of 2005 and have been a key tool that many public gas systems have used to secure long-term, firm supplies of natural gas for terms up to 30 years. One critical component of the prepay is an OTC swap transaction that enables the public gas system to ultimately pay a price discounted below the prevailing spot market price. Importantly, the OTC derivatives utilized in prepays are “tear up” agreements, that is, they terminate at no cost in the event the prepay terminates. Because of their size and long-range nature, requiring clearing of the prepay swap would be cost prohibitive.

Gas consumers need a strong, stable supply of natural gas and we need producers to continue to explore, find and produce America’s plentiful supplies of natural gas. Based on letters submitted by producer groups to Congress and to the Commission, it is our understanding that similar in its importance to public gas systems, the OTC market is also significant to producers. Many natural gas producers use OTC derivatives to customize their hedging transactions and thereby stabilize their cash flows in support of new exploration, production and other operating requirements (including labor costs). The credit requirements in the OTC market for producers is already addressed within existing agreements as it is for gas distributors, such as APGA’s members. Adding undue costs to the supply side of our industry will cause costly burdens to the producing and consuming community alike.

APGA notes that Congressman McMahon recently proposed “The Derivatives Trading Accountability and Disclosure Act.” This bill, among other provisions, would require the Commission and the Securities and Exchange Commission, in coordination with a new Office of Derivatives Supervision to be established within the Department of the Treasury, to determine which derivatives should be traded on exchanges, which derivatives should be traded through clearinghouses and which derivatives should be allowed to be traded on the OTC market though an OTC trade depository. Thus, the Derivatives Trading Accountability and Disclosure Act would permit non-standardized derivatives to continue to be traded OTC and not be subject to mandatory clearing. The decision about whether a particular derivative instrument is standardized or customized would be determined by the Commission or the SEC, taking into consideration: the volume of transactions; similarity of terms between the instrument and other more standardized instruments; whether the differences between the terms of the instrument and standardized instruments are of an economic significance; and the extent to which the terms are distributed to third parties.

APGA will be studying this proposed legislation more closely in the coming weeks and offering its views on it. However, even at this early stage, APGA and its members appreciate and support the bill’s recognition that the continued availability of individually negotiated, non-cleared OTC transactions is in the public interest. From our perspective, the continued availability of such transactions will provide our members the widest range of tools to continue to offer natural gas at the best possible prices to their customers. For this reason, APGA looks forward to working together with Chairman Gensler, the Commissioners and the Congress in finding the best possible market structure which protects American consumers of natural gas from manipulated or distorted prices but which also protects our ability to make wise use of sound and proven market tools for delivering gas to consumers at the best possible price.

Conclusion

APGA commends the Commission for its focus on the possible impact speculative investment has on the price of natural gas and other energy commodities and for asking these tough questions. Natural gas is a lifeblood of our economy and millions of consumers depend on natural gas every day to meet their daily needs. It is critical that the price those consumers are paying for natural gas comes about through the operation of fair and orderly markets and through appropriate market mechanisms that establish a fair and transparent marketplace. As noted above, as hedgers, public gas systems rely on speculative traders to provide liquidity and depth to the markets. Thus, APGA does not wish to see steps taken that would discourage speculators from participating in these markets using bona fide trading strategies. But more importantly, APGA's members rely upon the prices generated by the futures to accurately reflect the true value of natural gas.

The CFTC's conclusion in 1981 was that the ability of liquid markets to absorb excessively large speculative positions without suffering from artificial upward pressure on prices is not unlimited, and based on that reasoning, required exchanges to adopt speculative position limits for all contracts. That question, whether liquid markets have the ability to absorb excessively large speculative positions without suffering from artificial upward price pressure is the same question that is before the Commission today.

Accordingly, APGA believes that the Commission's conclusion reached in 1981 remains equally true today. For this reason, APGA would support additional regulatory controls, such as stronger speculative position limits, if a reasoned judgment can be made based on currently available, or additional forthcoming market data and facts, that such controls are necessary to address the unintended consequences arising from certain speculative trading strategies and/or to reign in excessively large speculative positions. However, APGA also recognizes that limits that cover only some of the variety of linked markets will not solve the problem, it would likely only push trading activity onto the less regulated market segments. Accordingly, to the extent that speculative investment may be increasing the price of natural gas or causing pricing aberrations, APGA strongly encourages the Commission to take strong remedial action. However, in doing so, the Commission and the Congress should take care that at the same time they do not decrease the utility that these markets so clearly provide. It will take wisdom and a carefully nuanced approach to erect additional regulatory controls that improve the manner in which these markets operate while at the same time preserving the benefits that they provide to consumers.