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AMERICAN PUBLIC GAS ASSOCIATION

July 23, 2007

COMMENT

Via E-Mail (secretary@cftc.gov)

Ms. Eileen Donovan
Acting Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St., N.W.
Washington, D.C. 20581

Re: Regulation 18.05

Dear Ms. Donovan:

The Commodity Futures Trading Commission ("Commission") has requested public comment on its proposal to amend Commission Rule 18.05.[1] The Commission is proposing to clarify its existing rule by making it explicit that the requirement that traders with a reportable futures or options position maintain books and records relating to all cash transactions in that commodity, includes books and records with respect to bi-lateral over-the-counter contracts and transactions conducted on electronic trading platforms. The amendment further clarifies that the Commission under Rule 18.05 may issue a special call to reportable traders for such information. The American Public Gas Association ("APGA") commends the Commission for proposing this clarification of its special call authority and strongly supports the Commission's proposed amendment to the language of Rule 18.05. However, as explained below, APGA believes that further steps are necessary to enable the Commission to carry out surveillance of the natural gas markets and thereby fulfill the "purpose of [the Commodity Exchange] Act to deter and prevent price manipulation or any other disruptions to market integrity . . . ."[2]

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 almost 700 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

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[1] "Maintenance of Books, Records and Reports by Traders, 72 *Fed. Reg.* 34413 (June 22, 2007). The Commission also has requested comment on its proposed rule amendment entitled "Special Calls," 72 *Fed. Reg.* 34413 (June 22, 2007).
[2] Section 3 of the Commodity Exchange Act, 7 U.S.C. §1 et.seq.
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systems, public utility districts, county districts, and other public agencies that have natural gas distribution facilities.

The Proposed Amendment

Commission Rule 18.05, 17 C.F.R. 18.05, is the special call provision that applies to any trader holding or controlling a reportable position on a regulated futures exchange.[3] Currently, Rule 18.05 provides that any such large trader is required to keep books and records showing "all details concerning . . . all positions and transactions in the cash commodity, its products, and by-products and in addition, commercial activities that the trader hedges in the commodity underlying the futures contract in which the trade is reportable." Rule 18.05 further provides that a large trader "shall upon request furnish to the Commission any pertinent information concerning such positions, transactions or activities." The Commission is proposing to amend the language of Rule 18.05 "to make it explicit that persons holding or controlling reportable positions. . . must retain books and records and make available to the Commission upon request pertinent information with respect to all . . . positions and transactions in the commodity . . . including transactions executed over-the-counter and/or pursuant to Sections 2(d), 2(g) or 2(h)(1-(2) of the Act. . . or on exempt commercial markets operating pursuant to Section 2(h)(2)-(5) of the Act."[4]

The Commission reasons that the proposed amendment would "make it explicit that persons holding or controlling reportable positions on a reporting market must also retain books and records and make available to the Commission upon request any pertinent information with respect to non-reporting [over-the-counter] transactions in the commodity in which the trader is reportable . . . ."[5] The Commission further reasons that this clarification would enable the Commission to better carry out its responsibilities to deter and prevent price manipulation or any other disruptions to the integrity of the regulated futures markets.[6] Finally, the Commission notes that "Commission staff has received such information in response to requests made pursuant to the Regulation."[7]

APGA is vitally concerned with the price integrity of the markets in financial contracts in natural gas. The economic links between the natural gas futures contracts traded on the New York Mercantile Exchange ("NYMEX") and those contracts, agreements and transactions in natural gas traded in the OTC markets are beyond dispute. Without question, a participant's trading conduct in one venue can affect, and has affected, the price of natural gas contracts in the other.[8]

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[3] Rule 18.05 applies with respect to positions held on both designated contract markets and registered derivatives transaction execution facilities ("DTEF"). No market has registered with the Commission to operate as a DTEF.
[4] 72 *Fed. Reg.* at 34414.
[5] *Id.* at 34416.
[6] *Id.*
[7] *Id.*
[8] *See "Excessive Speculation in the Natural Gas Market,"* Report of the U.S. Senate Permanent Subcommittee on Investigations (June 25, 2007) ("PSI Report"). The PSI Report on page 3 concluded that "Traders use the natural gas contract on NYMEX, called a futures contract, in the same way they use the natural gas contract on ICE, called a swap. . . . The data show that prices on one exchange affect the prices on the other."

Increasingly, the price of natural gas in many supply contracts between suppliers and local distribution companies ("LDC"), including APGA members, is determined based upon monthly price indexes closely tied to the monthly settlement of the NYMEX futures contract. Accordingly, the futures market serves as the centralized price discovery mechanism used in pricing these natural gas supply contracts. Any failure of the futures price to reflect fundamental supply and demand conditions results in prices for natural gas that are distorted and which do not reflect its true value. This has a direct effect on consumers all over the U.S., who as a result of such price distortions, will not pay a price for the natural gas that reflects bona fide demand and supply conditions.[9] For this reason, APGA and its members have a direct and substantial interest in the Commission's vigorous efforts to oversee the markets, to ensure fair and orderly markets, and to ensure that prices reflect market fundamentals.

The pricing anomalies experienced in the natural gas market in 2006 exemplify these linkages and the impact they can have on natural gas supply contracts for LDCs. Many natural gas distributors locked in prices during this period of elevated market prices. The Municipal Gas Authority of Georgia, a member of APGA, has calculated that as a result of the anomalous market prices in 2006, its members incurred hedging losses of $18 million over the actual market prices during the winter of 2006-07.

Because of the very real harm that can be suffered by APGA's members and their retail natural gas customers, whether or not they actually trade in the natural gas futures markets, APGA supports the CFTC in its efforts to strengthen its existing market surveillance program, including this proposal to clarify its special call authority. However, as the CFTC recently noted in testimony before Congress, it is "nearing the outer limits of its authority."[10] For this reason APGA has petitioned Congress to provide the CFTC with enhanced authority to conduct a comprehensive large trader reporting system with respect to trading in financial contracts in natural gas.

Need for Legislation

Although the CFTC has issued "special calls" to an electronic trading platform, and has proposed to clarify its authority to obtain information relating to OTC positions in response to a Special Call under Rule 18.05, the CFTC's large trader reporting surveillance system does not routinely reach traders' large OTC positions.[11] Reliance only on Special Call authority leaves open the potential for participants to engage in manipulative or other disruptive market behavior

[9] *See* the Congressional findings in Section 3 of the Commodity Exchange Act, 7 U.S.C. §1 et seq. ("Act"). Section 3 of the Act provides that, "The transactions that are subject to this Act are entered into regularly in interstate and international commerce and are affected with a national public interest by providing a means for . . . discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities."

[9] Hearing Before the Permanent Subcommittee on Investigations, Senate Committee on Homeland Security and Governmental Affairs, Testimony of the Commodity Futures Trading Commission (July 9, 2007) at p. 37.

[10] Hearing Before the Permanent Subcommittee on Investigations, Senate Committee on Homeland Security and Governmental Affairs, Testimony of the Commodity Futures Trading Commission (July 9, 2007) at p. 37.

[11] Special calls are generally considered to be extraordinary, rather than routine, requirements. Although special calls may be an important complement to routine reporting requirements in conducting market surveillance, they are not a substitute for a comprehensive large trader reporting system.

with little risk of detection until after the damage has been done to the market, ultimately costing the consumers or producers of natural gas. Accordingly, APGA supports legislation to provide the Commission with authority to operate a comprehensive large trader reporting system with respect to financial contracts in natural gas. Although the Commission has taken an important first step by proposing this clarification of the scope and meaning of Rule 18.05, legislation is needed to remedy this critical lack of transparency.

Need for greater public involvement

Finally, APGA believes that greater public involvement would assist the Commission as its policies necessarily evolve to meet the challenge of these new conditions in the energy markets. In this regard, APGA urges the Commission to establish an Advisory Panel on Energy Markets composed of industry experts, including representatives of consumer organizations, to offer technical advice on issues relating to reporting and surveillance of the markets, as well as spotting new trends and issues that it should address.[12]

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APGA appreciates this opportunity to comment on the proposed amendment to Regulation 18.05 and the Commission's consideration of our views.

Respectfully submitted,

Bert Kalisch
President & CEO

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[12] If it is not possible to gain approval for a formal Advisory Committee, APGA recommends that the Commission convene an on-going program of conducting Commission roundtables relating to these issues.