



AMERICAN PUBLIC GAS ASSOCIATION

November 15, 2010

VIA EMAIL: somalia@cftc.gov

Scott D. O'Malia
Commissioner
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Re: Section 724 (Segregation and Bankruptcy) of the Wall Street Reform and Consumer Protection Act (the "Act")

Dear Commissioner O'Malia:

Thank you for your letter of November 3, 2010 requesting the views of the American Public Gas Association ("APGA") on issues relating to segregation of client funds for cleared swaps. As you know, the cost and operation of the segregation, collateral and capital requirements relating to swaps as provided in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") is a fundamental concern of our members. APGA is pleased to offer its views on these issues.

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, public utility districts, county districts, and other public agencies that have natural gas distribution facilities.

Public gas systems depend upon both the physical commodity markets as well as the markets in over-the-counter ("OTC") derivatives to help meet the natural gas needs of their consumers. Together, these markets play a critical role in the hedging strategies many systems utilize to ensure a reliable supply of natural gas. Many, natural gas distributors use swaps to hedge very long-term agreements for the physical delivery of natural gas. It is doubtful that gas suppliers would be willing to enter into such very long-term contracts for physical delivery of gas without the ability to convert the pricing mechanism to a floating, spot pricing contract. In addition to the above hedging uses, many of our members also use exchange-traded or OTC derivatives to hedge their short and medium-term price risk associated with potential price volatility in the markets for the coming heating season, enabling them to provide their customers with more stable rates.

The Commission convened a staff roundtable on October 22, 2010 to discuss whether the Commission should abandon the omnibus account model ("Omnibus Option") currently used for

futures accounts in favor of segregation by individual customer account ("Individual Account Option") for cleared swaps. In your letter, you ask whether the additional cost associated with the level of protection of customer margin under the Individual Account Option would make end-users less likely or more likely to utilize clearing.

APGA has expressed concern during consideration by Congress of the bills that were eventually enacted as the Dodd-Frank Act that mandatory clearing of all transactions would significantly impair the financial ability of public gas systems to engage in hedging strategies. The end-user exemption which was included in the Dodd-Frank Act largely addresses this concern. Yet, some of our members do clear a portion of their OTC transactions and would certainly like to have available to them the continued choice to clear their OTC transactions at a reasonable cost. However, the manner in which the Commission implements the segregation requirement of section 724 of the Dodd-Frank Act may unnecessarily increase the cost of clearing and thereby create a disincentive to clear transactions.

During the October roundtable, the Chicago Mercantile Exchange and the Intercontinental Commodity Exchange agreed that the Individual Account Option would increase the cost of initial margin by more than 50%. As APGA has noted in the past, in the case of a standard OTC natural gas contract, the collateral that would be required to be posted under the current clearing regime would be approximately \$5,000 per contract. Hedging strategies by many of our members entail the holding of multiple contracts. In fact, one public gas system will hold up to 5,000 contracts as part of its strategy, requiring the posting of initial margin in the amount of \$25 million. Because many of our members have relatively high thresholds before they must post collateral on their OTC contracts, the cost of initial margin is a major factor in the decision of whether to clear their OTC transactions. Some members choose to clear a portion of their OTC transactions at current initial margin levels. An increase of initial margins of 50% or greater caused by mandating the Individual Account Option would discourage their choice to submit OTC transactions for clearing. Because of their non-profit structure, posting large amounts of initial margin would pose a challenge, which will be made all the greater by a significant increase in the amount of initial margin which would be required under the Individual Account Option.

Our members are familiar with the current segregation model and many transact in the futures markets and/or clear some portion of their OTC transaction. In our view, the omnibus account model currently employed for futures accounts has functioned well and provides adequate protection to an FCM's customers. To our knowledge, there have been few, if any, customer losses resulting from the insolvency of an FCM. Although swaps and futures are not identical instruments and the relative risk may vary between the two depending upon their terms, structure and liquidity, nevertheless it is not clear at this time that these differences, particularly with respect to those swaps that are likely to be subject to the mandatory clearing requirement, are so profound as to require a different form of customer segregation.

If, in spite of the foregoing concerns, the Commission determines to promulgate rules implementing the Individual Account Option, APGA urges the Commission to consider an approach to clearing requirements whereby FCM swaps customers would have the ability to choose between the Individual Account Option and the Omnibus Option. This would enable the cost of the higher protection offered by the Individual Account Option to be borne by those that

wish to avail themselves of it. As an alternative, the Commission should seriously consider any market-based solutions for offering enhanced protections to customers on a voluntary basis through insurance, establishing third party custody accounts or other solutions. These alternatives provide the possibility of offering end users a choice in the level of protection that they are provided. Such a choice would provide end users with greater transparency with respect to the cost of the level of protection that they choose.

Finally, imposing the Individual Account Option for swaps while leaving the current omnibus account system of segregation in place for futures could present operational challenges to end-users that trade both. The existence of two different segregation regimes would increase complexity for risk management, particularly if the two are not subject to margining as a single portfolio. Moreover, a bifurcated system possibly could cause dislocations and distortions in our member's hedging programs by introducing a cost differential for otherwise economically similar instruments.


Because of the importance of the issue and the possible harm that may come about through the admittedly well-intentioned consideration of the Individual Account Option, APGA strongly suggests that the Commission propose implementing such an option only after conducting a rigorous cost-benefit analysis. We note in this regard, that some of the required information may only be available after more of the regulatory framework for swaps has been implemented. Nevertheless, we believe that a studied approach to this issue is required. This would include an analysis of the market-based alternatives that may be available for offering particular customers a higher level of protection than that afforded by the omnibus account framework.

While we recognize that there may be important safeguards from the Individual Account Option, the Commission must take care lest it make the perfect the enemy of the good, in this case by mandating a segregation scheme which by its cost discourages the use of clearing.

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APGA commends the Commission's efforts to promulgate rules to implement the Dodd-Frank Act in a highly open and transparent manner and thanks you, Commissioner O'Malia, for seeking our input on this vitally important issue. APGA looks forward to working with the Commission throughout the course of the rulemaking process.

We would be happy to discuss our comments above at greater length with the staff. Please feel free to contact Dave Schryver at (202) 464-2742, or Paul M. Architzel of Alston & Bird, LLP, outside counsel to APGA at (202) 239-3492, if you have any questions regarding our comments.

Sincerely,

Bert Kalisch
President and Chief Executive Officer