AMERICAN PUBLIC GAS ASSOCIATION

November 24, 2014

Submitted Electronically

Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: Proposed Rule, "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants," 79 *Fed. Reg.*59898 RIN 3038—AC97 (October 3, 2014)

Dear Mr. Kirkpatrick,

The American Public Gas Association ("APGA") appreciates the opportunity to submit this comment on the Commodity Futures Trading Commission's ("Commission's") Notice of Proposed Rulemaking ("NPR")[1] further proposing margin requirements for certain swap dealers and major swap participants (collectively, "Covered Swap Entities") for uncleared swaps, as mandated by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").[2] APGA strongly supports the Commission's proposed decision not to require Covered Swap Entities to exchange margin with nonfinancial end users.[3] We remain extremely concerned, however, that the NPR does not in any way address an issue of great importance to APGA and to the American public as a whole, and one on which Congress has spoken, namely the treatment of Municipal Prepayment Transactions (described below), which allow public gas suppliers to hedge their long-term prepaid gas contracts.

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1 Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 *Fed. Reg.*59898 RIN 3038—AC97 (Oct. 3, 2014).

2 Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

3 APGA submitted a comment letter on the Commission's original proposed rules for margin and capital, dated July 7, 2011. Letter from Bert Kalisch to David Stawick Re: "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants," 76 *Fed. Reg.* 23732; RIN 3038—AC97 (April, 28, 2011); and "Capital Requirements of Swap Dealers and Major Swap Participants," 76 *Fed. Reg.* 27802; RIN 3038—AD54 (May 12, 2011), in which it expressed support for the Commission's proposed exemption from the margin rules for nonfinancial entities and also asked the Commission to modify its proposed capital rules to exempt transactions involving nonfinancial end users from any capital charge. APGA continues to request that the Commission take steps to ensure that capital charges on Covered Swap Entities are not passed on to nonfinancial end users.

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APGA raised this serious issue in an earlier comment letter to the Commission that focused solely on Municipal Prepayment Transactions.[4] However, the Commission does not appear to have given any consideration to our letter.

Because of its importance to the public, we raise this issue again and reiterate that without an exemption from mandatory margin and capital charges, Municipal Prepayment Transactions will likely be prohibitively expensive for prepaid gas suppliers to use to hedge their price exposure under prepaid gas contracts. These consequences will be felt not only by APGA members but by households and businesses across America. Moreover, in light of the increasing importance of natural gas as a clean energy source, Municipal Prepayment Transactions will be vital to the continued growth of the American economy. The consequence of the NPR, which would likely negate the practical availability of Municipal Prepayment Transactions, is in stark contrast to Congress' intent to encourage these transactions when it amended the Internal Revenue Code to establish a safe harbor applicable to them.

We restate our earlier comment on Municipal Prepayment Transactions below.[5] We have also included a graphic representation of a Municipal Prepayment Transaction at Appendix A to this comment. As we discuss more fully below, the Commission has the authority under the Dodd-Frank Act not to require margin for swaps that hedge commercial risk and that themselves involve no risk and pose no threat to the safety and soundness of a Covered Swap Entity. Indeed, it is on this basis that the Commission, we believe appropriately, proposes to exempt nonfinancial end users from margin requirements.[6]

I. Introduction

APGA's comments herein are addressed exclusively to the treatment of certain commodity swaps used to hedge municipal prepayment transactions for the supply of long-term natural gas or electricity ("Municipal Prepayment Transactions"). Municipal Prepayment Transactions have provided significant benefits to municipal utility systems and their customers across the United States for close to 20 years. As described in detail below and in Appendix A, these transactions are facilitated by a unique form of matched commodity swaps that allow the parties to a Municipal Prepayment Transaction to hedge their respective exposures to the changing price of the natural gas underlying the transaction with a single Covered Swap Entity or other financial entity. Each pair of matched commodity swaps is non-standardized and accordingly will not be cleared. All the material terms, notional quantities, tenor, and pricing points of the matched swaps are the same. They expressly contain no mark-to-market credit exposure to participants upon either early termination or replacement events. The matched swaps thus economically offset each other in every way. Under the structure of the Municipal Prepayment Transactions, neither swap will survive the termination of the prepayment transaction, and the prepayment transaction will not survive if both commodity swaps do not

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[4] Letter from Bert Kalisch to David Stawick, dated September 21, 2012, Re: Extension of Comment Period, "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants," 77 *Fed. Reg.* 41109 RIN 3038 – AC97 (July 12, 2011) ("Municipal Prepayment Letter"), attached hereto as Appendix B.

[5] Our restatement is substantially verbatim, modified to reflect issuance of the NPR and to make formatting and updating changes.

[6] *See* NPR, 79 *Fed. Reg.* at 59906.

remain in place. Accordingly, there is no counterparty, safety and soundness, or systemic risk associated with the matched commodity swaps in Municipal Prepayment Transactions.

While the counterparty to one of the swaps (the "front-end" swap) in a Municipal Prepayment Transaction is always a nonfinancial end user (it is typically a governmental gas supply agency), the counterparty to the other swap (the "back-end" swap), the prepaid gas supplier, may be a Covered Swap Entity or other financial entity. Thus the back-end swap could be subject to margin and capital requirements for uncleared swaps even though the prepaid gas supplier that is the counterparty to the back-end swap enters into the swap for the sole purpose of hedging its commercial risk and thus acts as a commercial end user in connection with the matched swap. Accordingly, under the current proposed margin rules, although the two matched swaps in a Municipal Prepayment Transaction economically offset and expressly have no mark-to-market exposure in the event of early termination or replacement, it is possible that each side of the pair would be subject to different margin treatment. And the imposition of mandated margin requirements on the back-end swap on the basis of mark-to-market calculations as if the swap did not "tear up" upon early termination or replacement would be cost-prohibitive, as would the passing along by the Covered Swap Entity or other financial entity of any capital charges associated with the matched swaps. None of these additional costs would provide any additional credit protection.

We understand and support the goal of ensuring reasonable credit safeguards in the derivatives arena. Nonetheless, we are concerned that the credit-safe and consumer-beneficial Municipal Prepayment Transactions, which because of their public importance are protected under the Internal Revenue Code,[7] could inadvertently be seriously harmed absent clarification that each side of the matched swaps that hedge these transactions will not require the posting or collection of margin.

As we discuss more fully below, the Commission has the authority under the Dodd-Frank Act not to require margin for swaps that hedge commercial risk and that themselves involve no risk and pose no threat to the safety and soundness of a Covered Swap Entity. Therefore, APGA requests that the Commission either exempt the matched commodity swaps described below from its margin requirements or otherwise clarify that no margin will be required in connection with these paired swaps other than any margin that might be required pursuant to negotiated credit support arrangements between the parties. For the same reasons, APGA also requests that the Commission make clear that additional capital will not be charged in connection with these swaps.

II. APGA

APGA is the national association of publicly-owned natural gas distribution systems. There are approximately 1,000 public gas systems in 37 states and over 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 systems, public utility districts, county districts, and other public agencies that have natural gas distribution facilities. In addition, APGA's membership includes, as agency members, a number

[7] *See* discussion below at III.

of governmental entities that do not own retail distribution systems but rather have been formed by municipalities under state law as joint action gas supply agencies, for the purpose of acquiring long-term gas supplies for municipal gas distribution systems and managing their transportation and storage on the interstate pipelines. Such joint action gas supply agencies are typically the parties to Municipal Prepayment Transactions to acquire long-term gas supplies at reasonable and competitive prices on behalf of and for the benefit of their municipal members. Our members and agency members are nonfinancial end users under the Dodd-Frank Act and thus will generally have available to them the end user exemption from clearing established by Section 731.

Public gas systems depend upon Municipal Prepayment Transactions to meet the natural gas needs of their consumers. However, if prepaid gas suppliers are required to post margin (or capital) to cover the tenor of the "back-end" swap as if it were not a "tear-up" swap, it would be prohibitively expensive for them to enter into the swaps. Moreover, prepaid gas suppliers will not enter into Municipal Prepayment Transactions at all if they are unable to hedge their long-term price exposure under the prepaid gas contract.

III. Municipal Prepayment Transactions and Matched Commodity Swaps

A. Municipal Prepayment Transactions

A Municipal Prepayment Transaction for natural gas is a set of contractual undertakings in which a governmental natural gas supply agency or its special purpose corporate instrumentality (a "gas agency") acquires a long-term supply of natural gas to meet the needs of retail gas consumers served by publicly-owned gas distribution systems or to generate electricity used by retail consumers of a municipal electric distribution system.

Under a Municipal Prepayment Transaction, the gas agency makes a lump sum advance payment (funded through an issuance of tax-exempt bonds) to a gas supplier for a predetermined quantity of natural gas, to be delivered in predetermined daily amounts at predetermined points of delivery pursuant to a long-term contract, typically 20 or 30 years in duration (the "Prepaid Gas Agreement").

Municipal Prepayment Transactions were developed by public gas systems to enable them to acquire a portion of their supplies on a long-term basis both to provide supply security and, by taking advantage of their ability as state and local governmental entities to issue tax-exempt bonds, to acquire such supplies at a discount to prices that they would otherwise pay in the market.

Municipal Prepayment Transactions financed with tax-exempt bonds are governed by U.S. Treasury Regulations, which provide that prepayment contracts that meet certain guidelines are not to be deemed a loan to the prepaid gas supplier and, consequently, are not subject to the arbitrage rules of Section 148 of the Internal Revenue Code. As part of the Energy Policy Act of 2005, Congress established a safe harbor under the Internal Revenue Code for Municipal Prepayment Transactions for natural gas (but not electricity) that meet the guidelines set forth in the statute.

under which one of the commodity swap agreements would remain in place while the other has been terminated early.

Early termination of a commodity swap agreement results in no payment of damages or any mark-to-market payment by either party to the other. Only amounts accrued under the commodity swap agreement for performance to the early termination date are payable upon its early termination. Accordingly, the commodity swap agreements are referred to as "tear-up" swaps. There is never any mark-to-market exposure borne by any of the three parties – the gas agency, the prepaid gas supplier, or the commodity swap counterparty – under the matched commodity swap agreements.

IV. Matched Commodity Swaps Entered Into to Hedge Municipal Prepayment Transactions Should Not be Required to Post Margin and Should Not be Subject to Incremental Capital

As discussed in our initial comment, APGA supports the Commission's proposed margin requirements insofar as they provide that commercial end users will not be required to post initial or variation margin for transactions with Covered Swap Entities beyond any margin that might be required pursuant to negotiated credit support arrangements between the parties.

The gas agency in a Municipal Prepayment Transaction is always a commercial end user. The prepaid gas supplier and the commodity swap counterparty, however, could be Covered Swap Entities or other financial entities. Accordingly, under the NPR, the front-end swap would not be subject to margin requirements; however, the back-end swap could be.

A. Both Matched Swaps in Municipal Prepayment Transactions Should be Exempted

Because the matched commodity swaps are mirror images of each other and are economically identical, they should be accorded the same regulatory treatment. Their "tear-up" nature underscores that they contain no inherent or residual risk and thus do not raise systemic or safety and soundness risks. Thus, both the gas agency and the prepaid gas supplier should be exempted from the margin requirements in connection with the matched commodity swaps (other than any margin that might be required pursuant to negotiated credit support arrangements between the parties), even if one of them is a Covered Swap Entity or other financial entity.

The Commission has expressly recognized that swaps used to hedge commercial risk, even when used by a Covered Swap Entity or other financial entity, do not raise the same concerns as swaps that are not used for such hedging. Swaps used to hedge physical positions or otherwise mitigate commercial risk thus do not have to be counted in an entity's determination of whether it is a swap dealer.[8]

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[8] Commission Regulation § 1.3(ggg)(6)(iii) provides that the determination of whether a person is a swap dealer will not take into account any swap entered into for the purpose of offsetting or mitigating the person's price risks that arise, among other things, from the potential change in the value of one or several commercial assets or services that the person provides or anticipates providing, as long as certain conditions that are designed to ensure that the swap is for legitimate commercial purposes and not to evade designation are met.

Similarly, the Commission has permitted potential major swap participants to exclude from the major swap participant determination certain swaps used for hedging commercial risk because it explicitly recognizes that counting swaps used for speculation, trading, or investment "will be sufficient to limit financial entities' ability to engage in risky transactions," thereby rendering the counting of swaps used to hedge unnecessary.[9]

APGA believes that a similar approach is appropriate for the matched commodity swaps at issue here and that no initial or variation margin should be required for matched commodity swaps entered into in connection with Municipal Prepayment Transactions as described above, regardless of whether the parties are Covered Swap Entities or other financial entities.[10]

B. The Commission is Authorized to Grant the Exemption

The Commission is authorized under Section 4s of the Commodity Exchange Act to determine the amount of margin to be applied to a particular type of swap transaction. Indeed, the statute requires that the amount of margin be calibrated to the risk of the uncleared swap. The margin must be designed to help ensure the safety and soundness of the Covered Swap Entity and also be "appropriate for the risk associated with the non-cleared swap" held as a Covered Swap Entity.[11] The matched commodity swaps at issue here pose no risk because they are matched in price, notional value, term, and termination conditions. In the event of a default, the swaps are simply "torn up."

C. Importance of Exemption

Since their inception in the 1990s, Municipal Prepayment Transactions hedged with the matched commodity swaps have served the twin purposes of providing long-term, secure gas supplies to municipal energy systems for sale to their customers for space heating, water heating, cooking, and other domestic, commercial, and industrial uses, and providing the gas at reasonable and competitive prices. As credit concerns have washed over the economy in recent years, these transactions have continued to provide secure gas supplies without the risk of the imposition of increased payment security obligations over time.[12] There is no question that Municipal Prepayment Transactions further important social and economic goals.

Margin requirements could make back-end commodity swaps prohibitively expensive for the financial entity counterparty and, consequently, could make the front-end swaps prohibitively expensive and unavailable for gas agency end users. Without the ability to hedge price fluctuations, APGA's members and agency members would not be able to continue to enter into

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[9] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant, 77 *Fed. Reg.* 30596, 30675 (May 23, 2012).

[10] As noted above, one side of the matched pair of swaps is always a commercial end user, such as a gas agency.

[11] CEA Section 4s(e)(3)(A).

[12] After Congress and the Federal Energy Regulatory Commission ("FERC") deregulated the purchase and sale of natural gas at the wholesale level in 1993, all gas distribution systems, public and private, began to be required to purchase all of their gas supplies under negotiated contracts. Gas pipelines thus went from providing bundled "citygate" service to being transporters, and the public gas distribution systems went from being purchasers of delivered gas supply at regulated prices to being purchasers of deregulated commodity supplies in the field and shippers under regulated transportation contracts.

Municipal Prepayment Transactions for natural gas, a consequence that is simply not appropriate for or justified by the absence of risk inherent in the matched commodity swaps.

Accordingly, these swaps should either be expressly exempted from margin requirements or the Commission should clarify that the initial and variation margin for these matched commodity swaps in connection with Municipal Prepayment Transactions will be set at zero.

V. Capital Also Should Not Be Required for Matched Commodity Swaps in Connection with Municipal Prepayment Transactions

While APGA's initial comment letter generally expressed support for the Commission's margin proposal as it would affect commercial end users, it raised concerns about the potential impact of the Commission's proposed capital rules on such end users.[13] We reiterate those concerns in relation to the matched commodity swaps at issue here. Even if margin is not required for these swaps, the counterparties to the matched commodity swaps will face increased costs to the extent that the proposed rules would apply a capital charge to the Covered Swap Entity in connection with the matched swaps. APGA is concerned that the Covered Swap Entity will simply pass on these increased costs to the gas agency, which will, as discussed above, impede its ability to enter into Municipal Prepayment Transactions.

APGA therefore respectfully requests that the Commission modify its proposed capital rules to exempt transactions involving matched commodity swaps used in connection with Municipal Prepayment Transactions from any direct or indirect capital charge.

VI. Conclusion

As we have noted in the past, natural gas is a lifeblood of our economy and millions of consumers depend on natural gas every day to meet their needs. APGA has long been supportive of the Commission's efforts to bring greater transparency to the over-the-counter swaps markets, including implementing measures designed to reduce risk, increase transparency and promote market integrity within the U.S. financial system. We appreciate the Commission's efforts to build a comprehensive framework on the foundation of the Dodd-Frank Act.

It is critical that APGA's members be able to continue to hedge their commercial risks within this framework without incurring undue and unnecessary additional costs. APGA thus supports the Commission's proposed rules on margin as they relate to commercial end users. We also urge the Commission to make clear that margin may not be imposed on any party in connection with matched commodity swaps that are used to facilitate Municipal Prepayment Transactions as described above. In addition, we ask that the Commission alter the proposed capital rules as necessary to protect all counterparties to matched commodity swaps used in connection with Municipal Prepayment Transactions from additional capital charges. Only in this way can APGA's members continue to reduce their exposure to commercial risk and provide their customers with natural gas at affordable stable rates.

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[13] Capital Requirements of Swap Dealers and Major Swap Participants, 76 *Fed. Reg.* 27802; RIN 3038—AD54 (May 12, 2011).

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We would be happy to discuss our comments at greater length with the staff. Please feel free to contact Bert Kalisch, President and CEO of APGA, David Schryver, Executive Vice President at 202-464-2742, Paul M. Architzel of Wilmer Cutler Pickering Hale and Dorr LLP at 202-663-6240 or Jim Choukas-Bradley of Miller, Balis & O'Neil, P.C. 202-296-2960, outside counsels to APGA.

Respectfully submitted,

Bert Kalisch
APGA President and CEO

cc: CFTC Chairman Timothy G. Massad
CFTC Commissioner Mark P. Wetjen
CFTC Commissioner Sharon Y. Bowen
CFTC Commissioner J. Christopher Giancarlo

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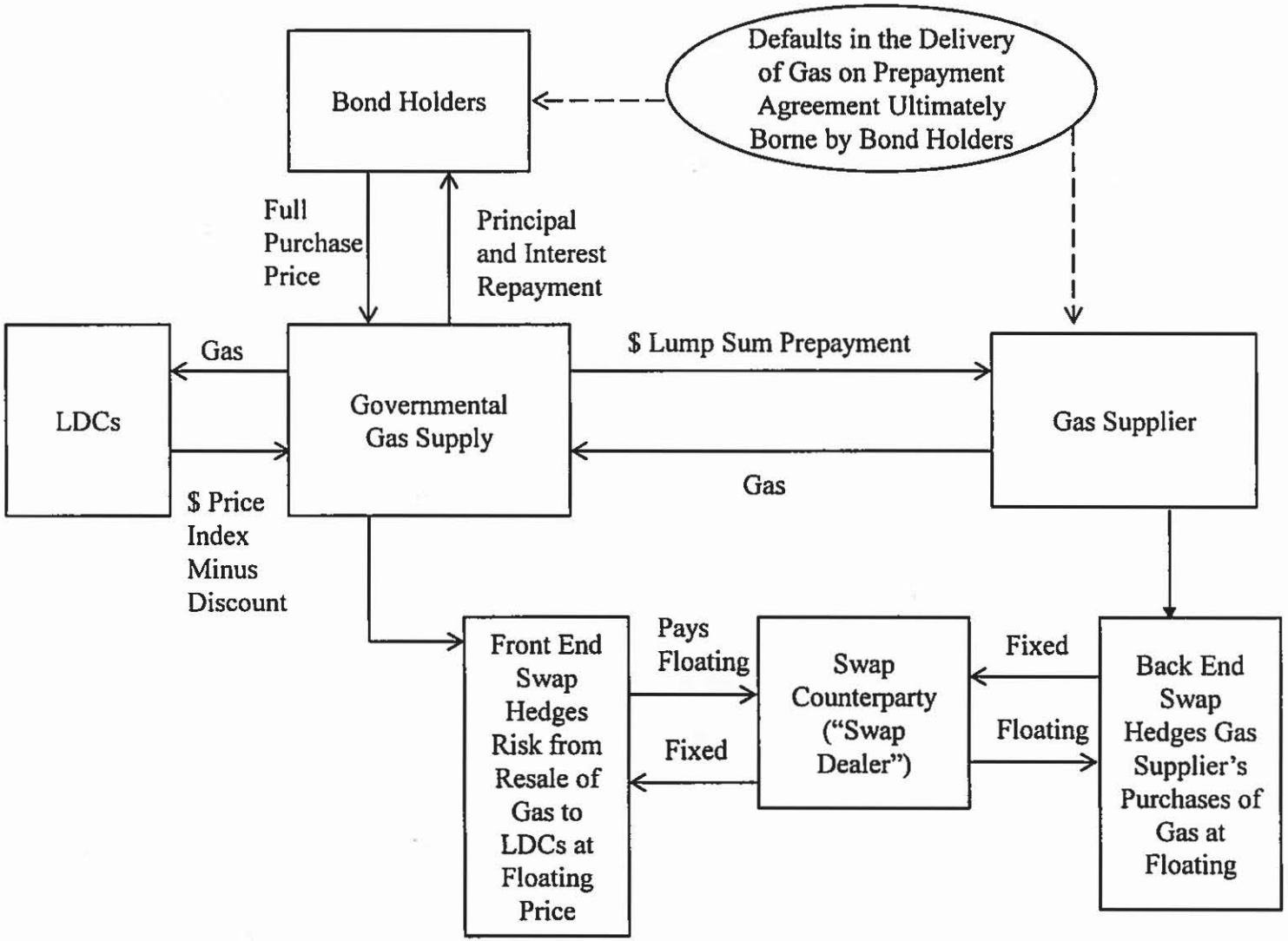
APPENDIX A

Graphic Representation of Municipal Prepayment Transactions



American Public Gas Association

September 21, 2012

Submitted Electronically

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
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Re: Extension of Comment Period, "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants," 77 *Fed. Reg.* 41109 RIN 3038—AC97 (July 12, 2011).

Dear Mr. Stawick:

The American Public Gas Association ("APGA") appreciates the opportunity to submit an additional comment on the Commodity Futures Trading Commission's ("Commission's") proposed margin requirements for swap dealers and major swap participants.[1] The Margin Notice proposes to implement margin requirements for uncleared swaps as mandated by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") [2] for certain swap dealers ("Swap Dealers" or "SDs") and major swap participants ("MSPs"). The Extension Notice is intended to provide interested parties the opportunity to comment concurrently on the Margin Notice and the recently-issued consultative paper on margin requirements for uncleared swaps issued jointly by the Basel Committee on Banking Supervision ("BCBS") and the International Organization of Securities Commissions ("IOSCO").[3]

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[1] Extension of Comment Period, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 77 *Fed. Reg.* 41109 (July 12, 2011) ("Extension Notice"); Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 *Fed. Reg.* 23732 (April, 28, 2011) ("Margin Notice"). APGA's initial comments are available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47727&SearchText=.

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

[3] BCBS and IOSCO, Margin requirements for non-centrally-cleared derivatives (July 2012) ("Consultative Paper"), available at: http://www.bis.org/publ/bcbs226.pdf.

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I. Introduction

APGA's comments herein are addressed exclusively to the treatment of certain commodity swaps used to hedge municipal prepayment transactions for the supply of long-term natural gas or electricity ("Municipal Prepayment Transactions").[4] Municipal Prepayment Transactions have provided significant benefits to municipal utility systems and their customers across the United States for close to 20 years. As described in detail below, these transactions are facilitated by a unique form of matched commodity swaps that allow the parties to a Municipal Prepayment Transaction to hedge their respective exposures to the changing price of the natural gas underlying the transaction with a single Swap Dealer. Each pair of matched commodity swaps is non-standardized and accordingly will not be cleared. All the material terms, notional quantities, tenor, and pricing points of the matched swaps are the same. They expressly contain no mark-to-market credit exposure to participants upon either early termination or replacement events. The matched swaps thus economically offset each other in every way, including that neither will survive the termination of the other. Under the structure of the Municipal Prepayment Transactions, neither swap will survive the termination of the prepayment transaction, and the prepayment transaction will not survive if both commodity swaps do not remain in place. Accordingly, there is no counterparty, safety and soundness, or systemic risk associated with the matched commodity swaps in Municipal Prepayment Transactions.

While the counterparty to one of the swaps (the "front-end" swap) in a Municipal Prepayment Transaction is always a nonfinancial end user (it is typically a governmental gas supply agency), the counterparty to the other swap (the "back-end" swap), the prepaid gas supplier, may be a swap entity or other financial entity. Thus the back-end swap could be subject to margin and capital requirements for uncleared swaps even though the prepaid gas supplier that is the counterparty to the back-end swap enters into the swap for the sole purpose of hedging its commercial risk and thus acts as a commercial end user in connection with the matched swap. Accordingly, under the current proposed margin rules, although the two matched swaps in a Municipal Prepayment Transaction economically off-set and expressly have no mark-to-market exposure in the event of early termination or replacement, it is possible that each side of the pair would be subject to different margin treatment. And the imposition of mandated margin requirements on the back-end swap on the basis of mark-to-market calculations as if the swap did not "tear up" upon early termination or replacement would be cost-prohibitive, as would the passing along by the swap entity of any capital charges associated with the matched swaps. None of these additional costs would provide any additional credit protection.

We understand and support the goal of ensuring reasonable credit safeguards in the derivatives arena. Nonetheless, we are concerned that the credit-safe and consumer-beneficial Municipal Prepayment Transactions, which because of their public importance are protected under the Internal Revenue Code,[5] could inadvertently be seriously harmed absent clarification that each side of the matched swaps that hedge these transactions will not require the posting or collection of margin.

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[4] Similar arrangements and issues exist for prepayments of gas and electricity supply. For simplicity, our comment focuses primarily on municipal prepayment agreements for long-term natural gas supplies, but our concerns are equally applicable to electricity supply.

[5] *See* discussion below at III.

As we discuss more fully below, the Commission has the authority under the Dodd-Frank Act not to require margin for swaps that hedge commercial risk and that themselves involve no risk and pose no threat to the safety and soundness of a swap entity. Therefore, APGA requests that the Commission either exempt the matched commodity swaps described below from its margin requirements or otherwise clarify that no margin will be required in connection with these paired swaps other than any margin that might be required pursuant to negotiated credit support arrangements between the parties. For the same reasons, APGA also requests that the Commission make clear that additional capital will not be charged in connection with these swaps.

II. APGA

APGA is the national association of publicly-owned natural gas distribution systems. There are approximately 1,000 public gas systems in 36 states and approximately 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 systems, public utility districts, county districts, and other public agencies that have natural gas distribution facilities. In addition, APGA's membership includes, as agency members, a number of governmental entities that do not own retail distribution systems but rather have been formed by municipalities under state law as joint action gas supply agencies, for the purpose of acquiring long-term gas supplies for municipal gas distribution systems and managing their transportation and storage on the interstate pipelines. Such joint action gas supply agencies are typically the parties to Municipal Prepayment Transactions to acquire long-term gas supplies at reasonable and competitive prices on behalf of and for the benefit of their municipal members. Our members and agency members are nonfinancial end users under the Dodd-Frank Act and thus will generally have available to them the end user exemption from clearing established by Section 731.

Public gas systems depend upon Municipal Prepayment Transactions to meet the natural gas needs of their consumers. However, if prepaid gas suppliers are required to post margin (or capital) to cover the tenor of the "back-end" swap as if it were not a "tear-up" swap, it would be prohibitively expensive for them to enter into the swaps. Moreover, prepaid gas suppliers will not enter into Municipal Prepayment Transactions at all if they are unable to hedge their long-term price exposure under the prepaid gas contract.

III. Municipal Prepayment Transactions and Matched Commodity Swaps

A. Municipal Prepayment Transactions

A Municipal Prepayment Transaction for natural gas is a set of contractual undertakings in which a governmental natural gas supply agency or its special purpose corporate instrumentality (a "gas agency") acquires a long-term supply of natural gas to meet the needs of retail gas consumers served by publicly-owned gas distribution systems or to generate electricity used by retail consumers of a municipal electric distribution system.

Under a Municipal Prepayment Transaction, the gas agency makes a lump sum advance payment (funded through an issuance of tax-exempt bonds) to a gas supplier for a predetermined quantity of natural gas, to be delivered in predetermined daily amounts at predetermined points

of delivery pursuant to a long-term contract, typically 20 or 30 years in duration (the "Prepaid Gas Agreement").

Municipal Prepayment Transactions were developed by public gas systems to enable them to acquire a portion of their supplies on a long-term basis both to provide supply security and, by taking advantage of their ability as state and local governmental entities to issue tax-exempt bonds, to acquire such supplies at a discount to prices that they would otherwise pay in the market.

Municipal Prepayment Transactions financed with tax-exempt bonds are governed by U.S. Treasury Regulations, which provide that prepayment contracts that meet certain guidelines are not to be deemed a loan to the prepaid gas supplier and, consequently, are not subject to the arbitrage rules of Section 148 of the Internal Revenue Code. As part of the Energy Policy Act of 2005, Congress established a safe harbor under the Internal Revenue Code for Municipal Prepayment Transactions for natural gas (but not electricity) that meet the guidelines set forth in the statute.

Debt service on the bonds results in a fixed cost per unit for the prepaid gas supplies. However, the sale price from the gas agency to its municipal gas distribution customers is referenced to market prices. Similarly, the purchases of gas supply by the prepaid gas supplier to meet its delivery obligations are at market prices, while its investment of the prepayment generally results in a fixed return that may be more or less than the cost of gas purchases. Thus the gas agency and the prepaid gas supplier both need to have their net cost of or revenue from the gas supplies reflect market prices, not fixed prices.

B. Hedging the Exposures from the Municipal Prepayment Transaction

The gas agency and the prepaid gas supplier both have exposure in the same notional quantities (the delivery quantities under the Prepaid Gas Agreement), for the same time period (the term of the Prepaid Gas Agreement), and at the same delivery points. Consequently, each is the natural party to enter into a commodity price swap transaction with the other. However, Section 1.148-1(e)(iii)(E) of U.S. Treasury Department Regulations by implication precludes the buyer and seller from swapping prices with each other directly. Accordingly, to hedge their exposure to the variability of market prices as compared to the fixed price inherent in the Municipal Prepayment Transaction, the gas agency and the prepaid gas supplier enter into matched commodity swaps. These are separately entered into by the gas agency and the prepaid gas supplier with the same third party commodity swap counterparty in order to enhance efficiency and reduce costs.

Because the two swap agreements are matched as to notional quantities, term, and pricing points, they are referred to as the "front-end swap" (between the gas agency and the commodity swap counterparty) and the "back-end swap" (between the prepaid gas supplier and the commodity swap counterparty). The bid-offer spread for the fixed price between the front-end and back-end swaps is the counterparty's fee for undertaking the role of swap counterparty.

The front-end commodity swap agreement provides for the payment by the gas agency of the floating index price each month on the notional volumes for that month and the payment by the commodity swap counterparty of the fixed price on the notional volumes for that month.

(other than any margin that might be required pursuant to negotiated credit support arrangements between the parties), even if one of them is a swap entity or other financial entity.

The Commission has expressly recognized that swaps used to hedge commercial risk, even when used by a swap entity or other financial entity, do not raise the same concerns as swaps that are not used for such hedging. Swaps used to hedge physical positions or otherwise mitigate commercial risk thus do not have to be counted in an entity's determination of whether it is an SD.[6]

Similarly, the Commission has permitted potential MSPs to exclude from the MSP determination certain swaps used for hedging commercial risk because it explicitly recognizes that counting swaps used for speculation, trading, or investment "will be sufficient to limit financial entities' ability to engage in risky transactions," thereby rendering the counting of swaps used to hedge unnecessary.[7]

APGA believes that a similar approach is appropriate for the matched commodity swaps at issue here and that no initial or variation margin should be required for matched commodity swaps entered into in connection with Municipal Prepayment Transactions as described above, regardless of whether the parties are SDs, MSPs, or other financial entities.[8]

B. The Commission is Authorized to Grant the Exemption

The Commission is authorized under Section 4s of the Commodity Exchange Act to determine the amount of margin, to be applied to a particular type of swap transaction. Indeed, the statute requires that the amount of margin be calibrated to the risk of the uncleared swap. The margin must be designed to help ensure the safety and soundness of the SD or MSP and also be "appropriate for the risk associated with the non-cleared swap" held as an SD or MSP.[9] The matched commodity swaps at issue here pose no risk because they are matched in price, notional value, term, and termination conditions. In the event of a default, the swaps are simply "torn up."

C. Importance of Exemption

Since their inception in the 1990s, Municipal Prepayment Transactions hedged with the matched commodity swaps have served the twin purposes of providing long-term, secure gas supplies to municipal energy systems for sale to their customers for space heating, water heating, cooking, and other domestic, commercial, and industrial uses, and providing the gas at reasonable and competitive prices. As credit concerns have washed over the economy in recent years, these transactions have continued to provide secure gas supplies without the risk of the

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[6] The Commission adopted as an interim final rule Regulation § 1.3(ggg)(6)(iii), which provides that the determination of whether a person is an SD will not take into account any swap entered into for the purpose of offsetting or mitigating the person's price risks that arise, among other things, from the potential change in the value of one or several commercial assets or services that the person provides or anticipates providing, as long as certain conditions that are designed to ensure that the swap is for legitimate commercial purposes and not to evade designation are met.

[7] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant, 77 *Fed. Reg.* 30596, 30675 (May 23, 2012).

[8] As noted above, one side of the matched pair of swaps is always a commercial end user, such as a gas agency.

[9] CEA Section 4s(e)(3)(A).

imposition of increased payment security obligations over time.[10] There is no question that Municipal Prepayment Transactions further important social and economic goals.

Margin requirements could make back-end commodity swaps prohibitively expensive for the financial entity counterparty and, consequently, could make the front-end swaps prohibitively expensive and unavailable for gas agency end users. Without the ability to hedge price fluctuations, APGA's members and agency members would not be able to continue to enter into Municipal Prepayment Transactions for natural gas, a consequence that is simply not appropriate for or justified by the absence of risk inherent in the matched commodity swaps.

Accordingly, these swaps should either be expressly exempted from margin requirements or the Commission should clarify that the initial and variation margin for these matched commodity swaps in connection with Municipal Prepayment Transactions will be set at zero.

V. Capital Also Should Not Be Required for Matched Commodity Swaps in Connection with Municipal Prepayment Transactions

While APGA's earlier comment letter generally expressed support for the Commission's margin proposal as it would affect commercial end users, it raised concerns about the potential impact of the Commission's proposed capital rules on such end users.[11] We reiterate those concerns in relation to the matched commodity swaps at issue here. Even if margin is not required for these swaps, the counterparties to the matched commodity swaps will face increased costs to the extent that the proposed rules would apply a capital charge to the covered swap entity in connection with the matched swaps. APGA is concerned that the swap entity will simply pass on these increased costs to the gas agency, which will, as discussed above, impede its ability to enter into Municipal Prepayment Transactions.

APGA therefore respectfully requests that the Commission modify its proposed capital rules to exempt transactions involving matched commodity swaps used in connection with Municipal Prepayment Transactions from any direct or indirect capital charge.

VI. Conclusion

As we have noted in the past, natural gas is a lifeblood of our economy and millions of consumers depend on natural gas every day to meet their needs. APGA has long been supportive of the Commission's efforts to bring greater transparency to the over-the-counter swaps markets, including implementing measures designed to reduce risk, increase transparency and promote market integrity within the U.S. financial system. We appreciate the Commission's efforts to build a comprehensive framework on the foundation of the Dodd-Frank Act.

It is critical that APGA's members be able to continue to hedge their commercial risks within this framework without incurring undue and unnecessary additional costs. APGA thus

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[10] After Congress and the Federal Energy Regulatory Commission ("FERC") deregulated the purchase and sale of natural gas at the wholesale level in 1993, all gas distribution systems, public and private, began to be required to purchase all of their gas supplies under negotiated contracts. Gas pipelines thus went from providing bundled "citygate" service to being transporters, and the public gas distribution systems went from being purchasers of delivered gas supply at regulated prices to being purchasers of deregulated commodity supplies in the field and shippers under regulated transportation contracts.

[11] Capital Requirements of Swap Dealers and Major Swap Participants, 76 *Fed. Reg.* 27802; RIN 3038—AD54 (May 12, 2011) ("Capital Notice").

supports the Commission's proposed rules on margin as they relate to commercial end users. We also urge the Commission to make clear that margin may not be imposed on any party in connection with matched commodity swaps that are used to facilitate Municipal Prepayment Transactions as described above. In addition, we ask that the Commission alter the proposed capital rules as necessary to protect all counterparties to matched commodity swaps used in connection with Municipal Prepayment Transactions from additional capital charges. Only in this way can APGA's members continue to reduce their exposure to commercial risk and provide their customers with natural gas at affordable stable rates.

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We would be happy to discuss our comments at greater length with the staff. Please feel free to contact Bert Kalisch, President and CEO of APGA, David Schryver, Executive Vice President at 202-464-2742, Paul M. Architzel of Wilmer Cutler Pickering Hale and Dorr LLP at 202-663-6240 or Jim Choukas-Bradley of Miller, Balis & O'Neil, P.C. 202-296-2960, outside counsels to APGA.

Respectfully submitted,

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