



AMERICAN PUBLIC GAS ASSOCIATION

09-7
①

July 13, 2009

VIA E-MAIL: secretary@cftc.gov

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

C.F.T.C.
OFFICE OF THE SECRETARIAT
2009 JUL 13 PM 4 18

Received CFTC
Records Section
7/13/09

Re: "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).

Dear Mr. Stawick:

The American Public Gas Association ("APGA") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("Commission") "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) ("Notice of SPDC Determination"). The Notice of SPDC Determination is the first review by the Commission of whether a particular contract performs a significant price discovery function under the new authority granted by the CFTC Reauthorization Act of 2008 ("Reauthorization Act").

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 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.

The Reauthorization Act

Over the past several years, and leading up to the passage of the Reauthorization Act, APGA has sounded the alarm with respect to the need for greater oversight and transparency of the over-the-counter ("OTC") markets in financial contracts in natural gas. APGA noted in testimony both before Congress and the Commission, that APGA's members have lost confidence that the prices for natural gas in the futures and the economically linked OTC

markets are an accurate reflection of supply and demand conditions for natural gas. APGA further testified that restoring trust in the validity of the pricing in these markets requires a level of transparency in natural gas markets which assures consumers that market prices are a result of fundamental supply and demand forces and not the result of manipulation or other abusive market conduct. APGA therefore strongly supported an increase in the level of transparency with respect to trading activity in these markets. For this reason, APGA supported enactment of the 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").

APGA applauds the Commission's quick promulgation of rules implementing its enhanced authority with respect to SPDCs traded on exempt commercial markets.¹ APGA further applauds the Commission for bringing this first proceeding to determine whether a contract performs a significant price discovery function. APGA believes that it is critically important for the Commission to remain committed to vigorous enforcement of this new authority.

The Proceeding

As an initial matter, APGA believes that it is appropriate to comment on the procedure of this first ever Notice of SPDC Determination. APGA recognizes that the determination of whether a particular contract serves a significant price discovery function must be made on the individual facts and circumstances of each such inquiry. The Commission, in part, relies upon an October 2007 report to demonstrate that "traders and voice brokers view the subject ICE contract as economically equivalent to the NYMEX . . . futures contract."² Although APGA agrees that such evidence is useful with respect to this particular case, it also cautions that such a focused and specific study should not be expected to be part of the evidentiary foundation with respect to each contract subject to a SPDC determination. Were the Commission to require such a study in relation to each individual notice of determination, it might make the process more resource intensive than Congress intended it to be. With that in mind, APGA urges the Commission to keep the process as efficient as possible so that it can enforce these provisions aggressively within its resource constraints.

Support for finding ICE Henry Financial LD1 Fixed Price Contract a SPDC

The Commission in its release asks commenters to provide written views, data and analysis that would address whether the ICE Henry Financial LD1 Fixed Price Contract for natural gas ("ICE Henry Hub Contract") is a SPDC. As noted above, APGA's members are publicly-owned natural gas distribution systems. APGA's membership includes both local gas distribution systems that hedge their individual gas purchases as well as state-level service units that hedge the gas purchases of local distribution systems. These members have direct experience as end-user buy side participants in exchange-traded and/or OTC derivatives markets. APGA's

¹ See, "Significant Price Discovery Contracts on Exempt Commercial Markets," 74 *Fed. Reg.* (Mar. 23, 2009).

² *Id.* at 2830.

comments rely upon the common experience of those of its members that are active users of the derivatives markets. These members are knowledgeable with respect to the operation of the cash markets in natural gas, NYMEX and the Intercontinental Exchange ("ICE").

The Commission asks commenters to address the four specific criteria that the Commission must consider: 1) price linkage; 2) arbitrage; 3) material price reference; and 4) material liquidity. Our analysis of each of these is as follows.

Price linkage

Our members recognize that the prices on the ICE Henry Hub contract and the NYMEX contract have an on-going, linked relationship. Our members report that this relationship extends not only to the linked settlement price, but to prices between the two contracts throughout the trading day. Members report that the prices of both markets are substantially the same and move in tandem. Counterparties will use either market interchangeably as a basis for quoting prices. This market practice and usage clearly support a finding of pricing linkage between the ICE Henry Hub contract and the NYMEX contract.

Arbitrage

As noted above, members uniformly report that the prices of the ICE Henry Hub contract and the NYMEX Henry Hub contract are closely linked, making arbitrage trading between the two markets possible.

Material Price Reference

APGA's members note that in general the written cash market contracts that they enter into reference the NYMEX settlement price, as does the ICE Henry Hub contract itself. Accordingly, the cash contracts that they enter into do not commonly explicitly reference the ICE Henry Hub contract as the settlement price. However, as noted above, it is common market practice for dealers to provide cash market price quotes based upon the ICE Henry Hub contract. Thus, the ICE Henry Hub contract is routinely used as a means by which cash market prices are referenced.

Material liquidity

APGA believes that the ICE Henry Hub contract is materially liquid. Whether or not our members trade the Henry Hub contract on ICE, they are of the opinion that they would be able to execute substantial sized orders without having an impact on the market price through the transaction. Our members note that there is a continuous stream of prices observed prices from the ICE Henry Hub contract and that there is little trading evidence that price concessions are necessary in order to execute a trade. Finally, APGA notes that the prices on the ICE Henry Hub contract are correlated with other contemporaneous prices

July 13, 2009

* * * * *

As APGA has 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 daily needs. It is critical that the price those consumers pay 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. For this reason, APGA supported enactment of the Reauthorization Act.

APGA commends the Commission's decision to initiate this first ever Notice of SPDC Determination. Based upon the analysis outlined above, APGA's members believe that the ICE Henry Hub contract is a significant price discovery contract and that the evidence and analysis provided to the Commission support such a determination.

APGA supported enactment of the Reauthorization Act in order to help restore trust in the validity of the pricing in these markets. As APGA noted previously, whether the Reauthorization Act achieves these goals largely depends in the first instance upon whether the Commission finds contracts to be SPDCs under the Act's provisions. Accordingly, in exercising this authority, the Commission must bear in mind that these provisions of the Reauthorization Act are remedial in purpose and intent and that the Commission as a consequence should carry out its mandate under the Reauthorization Act thoroughly and energetically.

We would be happy to discuss our comments or the evidence and analysis of our members discussed above 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, or Paul M. Architzel of Alston & Bird, LLP, outside counsel to APGA at 202 756-3492.

Respectfully submitted,

c: Chairman Gensler
Commissioner Dunn
Commissioner Chilton
Commissioner Sommers
Daniel Berkovitz, General Counsel
Richard A. Shilts, Director DMO
Susan Nathan, Senior Special Counsel
Gregory Price, Industry Economist