



December 9, 2009

Dear Representative:

**When the House begins debate on the OTC derivatives issue, the undersigned associations, representing the electric and natural gas industries serving nearly every energy customer in the United States, urge you to oppose any proposed amendments that would undermine the end-user exemption from mandatory clearing and margining requirements in Title III, the Derivatives Markets Transparency and Accountability Act of 2009, of H.R. 4173, the Wall Street Reform and Consumer Protection Act of 2009.** We use over-the-counter (OTC) derivatives extensively to manage commodity price risk for electric power, natural gas and other fuels, as well as to contain risk related costs when financing energy infrastructure. While we support the goals of the Administration and the Congress to improve transparency and stability in OTC derivatives markets, it is essential that policy makers preserve the ability of companies to access critical OTC energy derivatives products and markets. Our members rely on these products and markets to manage price risk and to help to keep rates stable and affordable for retail consumers. Importantly, we would like to clarify that we represent only the listed energy sector organizations and not any financial or banking institutions. Our interests are focused on commercial risk management practices and well-functioning energy markets. For the reasons delineated below, we urge you to oppose amendments which would undermine legitimate hedging activity.

**SPECIFICALLY, WHEN THE LEGISLATION IS CONSIDERED ON THE HOUSE FLOOR, WE STRONGLY URGE YOU TO SUPPORT THE MURPHY (#129) AMENDMENT TO EXEMPT LEGITIMATE END-USER HEDGING BY EXCLUDING END-USERS FROM THE DEFINITIONS OF "SWAP DEALER" AND "MAJOR SWAP PARTICIPANT"; SUPPORT THE MCMAHON (#224) AMENDMENT EXEMPTING "BOOK OUT" TRANSACTIONS (TRANSACTIONS THAT MAY NOT BE "PHYSICALLY SETTLED") FROM MANDATORY CLEARING REQUIREMENTS; AND OPPOSE THE FRANK (#66) AMENDMENT TO PERMIT CFTC AND/OR SEC FROM IMPOSING MARGINING REQUIREMENTS ON LEGITIMATE HEDGING TRANSACTIONS BY REQUIRING MANDATORY CLEARING.**

- 1) The bill is properly focused on financial reform to avoid future systemic risks.** We believe that OTC reform should strike an appropriate balance between: (1) establishing market oversight rules that provide regulators with the ability to establish a high level of transparency and protect consumers against systemic risk and market manipulation, and (2)

providing end-users with continued access to a broad range of market-based risk management tools. Reform should not punish companies engaged in legitimate commercial risk management practices, which do not pose systemic risk and did not contribute to the financial crisis in any manner. Nor should reform punish the consumers they serve due to a one-size fits all approach to reform.

- 2) Unfortunately, amendments to undermine the current clearing and margin exemptions or impose additional regulatory uncertainty on end-users engaged in commercial risk management would do just that. The current OTC Title III of HR. 4173, reflecting compromise language between Chairmen Peterson and Frank, is a legitimate attempt at striking the balance we support. Furthermore, Title III promotes clearing of standardized derivatives, where appropriate, between systemically significant financial dealers and institutions to reduce systemic risk and bring additional transparency through information regarding pricing, volume and risk. It does not inappropriately mandate that all or most end-user OTC transactions must be cleared, exchange traded or executed on new “swap execution facilities”, which our members strongly oppose. **Attempts to require that all non-cleared swaps be executed on newly created swap execution facilities could undermine the current clearing exemption.**
- 3) **There is no suggestion that energy/electricity OTC transactions were implicated in the financial crisis or pose future systemic risks.** The objective of clearing and exchange trading is to not only increase transparency but to reduce systemic risk. Our members do not pose systemic risk to the broader economy. In fact, the entire commodity market is less than one percent of the global OTC derivatives market, and the energy commodity portion is yet a fraction of that one percent. Additionally, our members would not benefit from mandatory clearing or exchange trading requirements. The available evidence shows that clearing and exchange trading would not bring pricing benefits that would offset the cost of margining for gas and power derivatives, as some have suggested. The high cash margin requirements would significantly increase transaction costs for our members and, ultimately, their retail customers. As a result, many of our members would elect to reduce or eliminate their hedging practices altogether, a result that is likely to be detrimental to our customers.
- 4) **The Financial Services and Agriculture Committees wisely did not apply mandatory clearing or margin for end-users in the OTC Reform Title, but instead promote transparency through the use of OTC data repositories and various reporting requirements.** Section 3103 of Title III requires the mandatory reporting of all swaps that are not centrally cleared to a registered swap repository or directly to the CFTC if no repository will accept it. Section 3106 requires the establishment of strict reporting and recordkeeping requirements for swaps that were not accepted by a repository. Section 3107 requires reporting and record keeping for each major swap participant and swap dealer as well as requires that they maintain daily trading records of all swaps and daily trading records for each customer or counterparty. Furthermore, Section 3107 also delineates criteria governing business conduct standards and related requirements that major swap participants and swap dealers must comply with over the course of business.
- 5) **Floor amendments to require mandatory trading of non-cleared swaps on swap execution facilities or allow the CFTC to impose margin and collateral on end-users will undermine the purposes of commercial risk mitigation.** Undermining the exemption from mandatory clearing and margining would adversely affect the ability of end-users to effectively manage and hedge against commodity price risk for fuels used for the direct-use of natural gas, to produce electricity, as well as the power generated by plants. This result would lead to increased costs for energy providers and higher prices for consumers across

the country. Due to the high cash collateral and margin requirements associated with clearing and exchange trading, a requirement to execute all risk management instruments on new swap execution facilities or exchanges could potentially impose extremely large and untenable cost increases on entities that do not pose systemic risk.

- 6) In contrast, individually-negotiated OTC contracts allow these commercial entities to use alternative collateral structures such as asset liens, credit lines or no collateral below agreed upon thresholds. In some cases, because of the very high credit worthiness of an entity there will be a reasonable threshold that must be reached before collateral would have to be posted. Providing such flexibility frees up scarce capital for investments in new energy infrastructure and environmental upgrades at existing facilities as well as preserving the ability to protect consumers from price volatility by hedging risk. Conversely, not allowing such collateral structures and imposing defacto clearing requirements (or requiring higher capital and margin requirements for customized transactions) would reduce market liquidity, severely limit these entities' product and service offerings to consumers, unnecessarily divert substantial capital from productive investments and drive up the price of energy commodities at a time when our nation is recovering from the greatest economic downturn since the Great Depression. **Therefore, we urge you to vote NO on any amendments that would undermine our ability to mitigate risks to our businesses and our consumers. These amendments would needlessly tie up capital better invested in energy infrastructure to create jobs.**

In closing, we respectfully request that you carefully consider the adverse and unintended consequences that such amendments would have on legitimate energy end-users, whose transactions pose no systemic risk and did not contribute to the financial crisis in any manner. The cost implications to our customers will be severe. **Please vote NO on any amendments that would roll back the end-user exemption or otherwise jeopardize our ability to best serve consumers.**

Sincerely,

American Gas Association  
American Public Gas Association  
American Public Power Association  
American Wind Energy Association  
America's Natural Gas Alliance  
Edison Electric Institute  
Electric Power Supply Association  
Independent Petroleum Association of America  
Natural Gas Supply Association  
National Rural Electric Cooperative Association