January 25, 2011

Via Electronic Mail: rule-comments@sec.gov

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Subject: **Energy End User Comments Regarding Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies Advanced Notice of Proposed Rulemaking**

Dear Ms. Murphy:

The coalition of energy end-users who have signed this letter offer the following comments in response to the Commodity Futures Trading Commission ("CFTC") December 2, 2010 Advanced Notice of Proposed Rulemaking regarding the Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies ("ANOPR"). The ANOPR seeks comments on different regulatory options (or models) to protect margin collateral posted by customers clearing swaps transactions. The energy end-users in the coalition make extensive use of swaps and futures to manage the commercial risks associated with their businesses, and the mechanics used by futures clearing merchants ("FCMs") and derivatives clearing organizations ("DCOs") to manage customers' collateral can have a significant impact on the cost of hedging. As such, CFTC adoption of the wrong collateral segregation model would significantly increase end-users' costs of hedging.

As an initial matter, the potential cost increases associated with some of the collateral segregation models underscores the importance of properly exempting energy end-users from the Act's mandatory clearing requirement, as consistent with Congressional intent. In general, because of the physical nature of their asset bases, energy end-users can be particularly sensitive to the kind of increased cash margin requirements that may result under some of the proposed segregation models. Congress's goal in providing the end-user exemption to the mandatory clearing requirement was "to protect end-users from burdensome costs associated with margin requirements and mandatory clearing."[1] As such, the increased costs likely to result under some of the collateral segregation models highlight the need for the CFTC to

[1] Letter from Sen. Christopher Dodd and Sen. Blanche Lincoln to Rep. Barney Frank and Rep. Colin Peterson 2 (June 30, 2010) (the "Dodd-Lincoln Letter").

exempt energy end-users from the mandatory clearing requirement consistent with Congressional intent. In addition to the model for collateral segregation, appropriately defining the terms "swap dealer" and "major swap participant" is central to honoring the Congressional intent to protect end users from burdensome costs.

With respect to the models set forth in the ANOPR, the coalition believes that the existing omnibus model has served the derivatives market well in protecting against both individual and systemic risk while allowing transaction costs to remain at a reasonable level. This model has multiple layers of protection, between the FCMs, DCOs, capital and margin requirements, credit reviews, existing segregation requirements, default funds, etc. This system performed well in protecting U.S. customers from the effects of the Lehman bankruptcy during the onset of the global financial crisis—a rather severe test. Along those lines, energy end-users—who were not among those responsible for the financial crisis and whom Congress intended to spare from burdensome costs under the Act—should not be subject to the increased costs that might result from switching away from a model with a proven track record.

The energy end-users have reservations with respect to the mandatory individual account models for FCMs and DCOs because of resulting increase in collateral requirements noted by CFTC roundtable participants. As mentioned above, energy end-users can be particularly sensitive to such cash margin requirements because their asset bases tend to contain more physical assets and relatively fewer financial assets than other market participants. To the extent that an energy company, or any commodity producer, has to invest its capital in margins, that capital is not available for exploration, production or expanding infrastructure. While the large number of energy end-users that voluntarily clear today might continue to do so in spite of such increased transactional costs, such costs could, in fact, discourage other end-users from clearing or perhaps from hedging at all. Adopting an individual account model would unnecessarily increase risk management costs when, in fact, the current model's ability to serve the derivatives market well has been recently tested and proven.

That said, the coalition is generally supportive of providing for additional choice in the market. Therefore, all things being equal, the coalition would be supportive of providing DCOs and FCMs with the flexibility to offer individual segregated accounts as an option while still providing a pooled account to clients choosing to continue to operate under the omnibus model. However, several commenters at the roundtable raised important concerns regarding such an optional individual account model resulting in the same increased costs as the mandatory individual account model. Therefore, market options, such as clients becoming FCMs themselves or purchasing tailored insurance products, may be more efficient means of offering the additional protection sought by certain market participants. As such, the CFTC should consider the availability of such market options as it seeks to implement a rule that will best serve the market.

To summarize, the coalition of energy end-users believes that it is essential that the transaction costs and the amount of working capital associated with FCM and DCO collateral management be kept at a reasonable level. The current omnibus model has achieved this goal while protecting against both individual and systemic risks. While the coalition is generally supportive of providing additional choice in the market, including the provision of an individual account option, the coalition is concerned about the cost impacts the individual account model might have, even if implemented only as an option. In that regard, it is worth remembering that the Act was primarily adopted to address systemic, not individual risk, and that other available market tools could provide the added individual protections sought by certain market participants. Finally, the potential for cost increases associated with implementation of the various segregation models highlights the importance of the CFTC adhering to congressional intent in properly exempting end-users from the mandatory clearing requirement, thus allowing end users to retain the flexibility to manage their individual risks as best suits their businesses. Just like the best defense is a good offense, a collateral segregation mandate with a high price tag for end users cannot replace sound, efficient and diversified risk mitigation strategies.

Respectfully submitted,

Natural Gas Supply Association
American Gas Association
Edison Electric Institute
Independent Petroleum Association of America
Southwestern Energy