



AMERICAN PUBLIC GAS ASSOCIATION

July 21, 2009

The Honorable Timothy F. Geithner
U.S. Secretary of Treasury
Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Geithner:

On behalf of the American Public Gas Association (APGA), I express our strong concern with proposals that would require public gas systems to clear their over-the-counter (OTC) derivative transactions. Although APGA has been a strong supporter of increasing transparency and market oversight, proposals that would require public gas systems to clear their OTC derivatives transactions would have a significant impact upon the financial operations of these systems, ultimately increasing the cost to the consumer.

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 OTC derivatives to meet the natural gas needs of their consumers. Together, these markets play a critical role in these utilities securing natural gas supplies at stable prices for their communities. Specifically, natural gas distributors purchase firm supplies in the physical delivery market at prevailing market prices, and enter into OTC derivative agreements customized to meet their specific needs, reduce their consumers' exposure to future market price fluctuations and stabilize rates. By using both markets, these public gas systems are able to purchase firm deliveries of natural gas from a diverse set of suppliers while hedging the risk of future market price fluctuations. For these reasons, APGA has pushed for the passage of legislation and regulations that increase transparency and help ensure that the OTC markets are an accurate reflection of supply and demand conditions for natural gas.

However, proposals within the administration and Congress that would require all standardized OTC derivatives transactions to be cleared would significantly impair the financial ability of public gas systems to engage in these gas supply strategies. The mandated clearing of all OTC transactions would require public gas systems to post initial margin and to meet potential margin

calls whenever required on little notice. This would constitute a significant financial and operational burden on these systems, their communities and their consumers.

In the case of a standard exchange traded natural gas contract, the initial margin collateral that would be required to be posted is approximately \$5,000 per contract. Supply 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 supply strategy. Because many of our members under an OTC Credit Support Annex may have sizable thresholds before collateral on their OTC contracts is required to be posted, requiring the posting of initial margin associated with clearing the same contracts, would significantly increase the cost of carrying such positions to a public gas system. For the public gas system that holds 5,000 contracts this might be as high as requiring the posting of \$25 million in margin when no collateral would have been required under their bi-lateral Credit Support Annex. Further postings of maintenance and variation margins are also required for exchange traded clearing and, depending on market moves and timing can be multiples of the initial margin requirement. Because of their non-profit structure, posting such large amounts of collateral would pose a significant challenge and cost to public gas systems and their consumers.

Another result of mandatory clearing on public gas systems would be the de facto elimination of the use of tax-exempt financing for the prepayment of long-term natural gas contracts, also known as "prepays". Prepays were endorsed by Congress as part of the Energy Policy Act of 2005 and have been a key tool that many public gas systems have used to secure long-term, firm supplies for terms up to 30 years. One critical component of the prepay is an OTC swap transaction that enables the public gas system to ultimately pay a price discounted below the prevailing spot market price. Importantly, the OTC derivatives utilized in prepays are "tear up" agreements, that is, they terminate at no cost in the event the prepay terminates. Because of their size and long-range nature, requiring clearing of the prepay swap would be cost prohibitive.

APGA understands that provisions that require the clearing of all OTC transactions are intended to address issues related to systemic risk. However, the hedging of natural gas supply purchases by public natural gas systems using non-cleared bi-lateral OTC derivatives do not present the types of systemic risks posed by some dealers of credit-default swaps, which is the impetus behind the proposed clearing mandate. Moreover, the proposed mandate to clear all standardized OTC derivatives transactions would increase costs for public gas systems and their municipalities; an increase which would be borne 100% by their consumers. I look forward to working with you and others towards protecting consumers from these cost increases.

Sincerely,

A handwritten signature in black ink, appearing to read "Bert Kalisch". The signature is fluid and cursive, with a prominent initial "B".

Bert Kalisch
President & CEO