FERC GAS RULES

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FERC

- The Federal Energy Regulatory Commission regulates the wholesale sale and transmission of electricity in interstate commerce, the transportation of natural gas and refined petroleum products by pipeline and hydroelectric dams.
- Governing statutes, primarily the Federal Power Act and the Natural Gas Act.

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Policy Behind
Capacity Release Rules

- The underlying policy behind the capacity release rules is that the entity that signs up for the interstate pipeline capacity must be the one that uses the capacity when transporting gas. To the extent that capacity is not needed by that entity, then the entity can release it. In the end, the entity does not have the ability to give capacity to whoever they want. Everyone must have a chance to reserve the capacity. Therefore the FERC requires that capacity must be released on an open access, non-discriminatory basis using processes and pricing guidelines approved by the FERC and implemented by the pipelines.
- FERC wants both the use of primary (pipeline capacity) and secondary capacity (capacity release) to be transparent.

Releasing Shippers Have Significant Flexibility in Releasing Capacity

- Releasing shippers cannot impose on replacement shippers' different terms and conditions of service than in the pipeline tariff but can dictate different rates.
- Recent FERC *Transwestern* case, said the "reservation charge component of the replacement shipper's rate for all service within the applicable rate zone, both within and outside the primary path, must be the capacity release rate determined through negotiations between the releasing and replacement shippers and any required bidding on the release" and a replacement shipper using a secondary point, "is [not] automatically entitled to pay the same discounted rate as the releasing shipper pays for service at that point."
- So don't assume that the pipeline tariff rates will govern the price paid by the replacement shipper; must check the releasing/replacement shipper agreement.

Capacity Release Rules (Cont'd)

- FERC prohibits circumvention of the capacity release rules by:
  - Requiring the shipper that holds the capacity to have title to the gas during transport, the so-called "shipper-must-have-title" rule.
  - Banning "buy/sell" arrangements, where "the purchases, transportation, and re-sales were for the purpose of meeting the gas requirements of a third party, but there no capacity release to any participant in the transactions."
  - Banning "flipping" arrangements – a series of short-term releases of discounted rate capacity to two or more affiliated or unaffiliated shippers on an alternating monthly basis in order to avoid the competitive bidding requirement for discounted long-term capacity releases.

Question: Which one of these examples is okay under shipper must have title?

1. Marketer sold gas to affiliated generating units and used the pipeline capacity rights of the generating plants to deliver the gas. Marketer maintained title to the gas during transport.
2. Marketer delivered gas to affiliates using the pipeline capacity rights of other affiliates. Marketer maintained title to the gas during transport.
3. Marketer delivered gas to unaffiliated third parties using the pipeline capacity rights of affiliates. The marketer or the third party did not have title to the gas during transport.

Answer

- None, because in each there is a mismatch between: (i) the shipper holding the title to the gas, and (ii) the shipper holding the capacity.
- The exact same legal entity must hold: (i) the capacity on the pipeline, and (ii) title to the gas when the capacity is being used.
- If there is a mismatch between the: (i) exact legal entity holding the capacity, and (ii) the exact legal entity holding title to the gas, that is a red flag and you must immediately bring the matter to the attention of your compliance officer.

Examples of Flipping

- Sometimes FERC goes after the flipper.
  - Piedmont released capacity on Transcontinental Gas Pipe Line Corporation to four sets of affiliated replacement shippers on an alternating monthly basis.
- Sometimes FERC goes after the flippee.
  - WPS ESI and WPS Gas Storage engaged in flipping by taking discounted short-term firm capacity released by a shipper on the ANR LINK system on an alternating basis during thirteen of the winter months of 2004, 2005, and 2006.

Buy-sells

- A prohibited buy/sell transaction is a commercial arrangement where a shipper holding interstate pipeline capacity buys gas at the direction of, on behalf of, or directly from another entity (*e.g*., an end-user), ships that gas through its interstate pipeline capacity, and then resells an equivalent quantity of gas to the downstream entity at the delivery point.
- Examples
  - South Jersey Gas took title to gas at a receipt point on Transco and delivered gas in equivalent volumes to the same counterparty at a downstream delivery point on Transco.
  - South Jersey Gas entered into a transaction with a third party whereby South Jersey Gas bought 0.5 Bcf of natural gas at a storage facility on Transco and agreed to deliver the same volume ratably to the third party at a downstream delivery point on Transco.

Capacity Release Bidding Requirements

	31 days or less	Between 31 days and 1 year	More than 1 year
Order 712 Rules 1. General	Any rate – no bidding requirement	Any rate – must be bid	If max rate – no bidding requirement, otherwise must be bid
2. Rollover	Must be bid	Must be bid	Can rollover if both parties agree and at max rate
3. Asset Manager	No bidding requirement, even if rollover	No bidding requirement, even if rollover	No bidding requirement, even if rollover
4. Marketer in State Retail Program	No bidding requirement, even if rollover	No bidding requirement, even if rollover	No bidding requirement, even if rollover

Rate Rules for Capacity Release

	31 days or less	Between 31 days and 1 year	More than 1 year
1. General	N/A	N/A	Pipeline's Max Rate is the cap
2. Asset Managers	N/A	N/A	Pipeline's Max Rate (but other considerations will not be counted toward cap)
3. Marketer in State Retail Program	N/A	N/A	Pipeline's Max Rate is the cap

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Asset Management Agreement ("AMA")

Generally

- FERC has an exemption from the prohibition against tying and an exemption from capacity release bidding auction requirements for AMAs.
- Definition of AMA:
  - Any pre-arranged release that contains a condition that the releasing shipper may, on any day during a minimum period of <u>five months out of each twelve-month period of the release</u>, call upon the replacement shipper to (i) deliver to the releasing shipper a volume of gas <u>up to one hundred percent of the daily contract demand</u> of the released transportation capacity of (ii) purchase a volume of gas up to the daily contract demand of the released transportation capacity.
  - If the capacity release is for a period less than one year, the asset manager's delivery or purchase obligation described in the previous sentence must apply for <u>the lesser of five months or the term of the release</u>.
  - If the capacity release is a release of <u>storage capacity</u>, the asset manager's delivery or purchase obligation need only be <u>one hundred percent of the daily contract demand under the release for storage withdrawals or injections, as applicable</u>.

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Specific Capacity Release Rules Applicable to AMA and State Retail Access Program

AMA

- Any entity holding interstate transportation capacity may enter into an AMA as a releasing shipper.
- The parties to an AMA can specify a deadline in their AMA agreement after which the asset manager may re-release the capacity without attaching a recall provision.
- A releasing shipper may include more capacity in an AMA than it has previously used to meet its needs, provided that the releasing shipper owns that capacity and that the delivery/purchase obligation in the AMA applies to all the capacity included in the AMA.
- An asset manager may release capacity it obtained as part of an AMA to another asset manager, provided each release is made to implement an AMA and satisfies the delivery/purchase obligation and other criteria in the definition of AMA.

Specific Capacity Release Rules Applicable to AMA and State Retail Access Program (Cont'd)

Retail Access

- Exemption applies to marketers participating in state-regulated retail access programs as long as the marketer replacement shipper is obligated to use the capacity to provide the gas supply requirement of retail consumers.
  - Marketer participating in a state approved retail access program can re-release its capacity to an asset manager that will fulfill the marketer's obligations under the state approved program. The release must have a connection to serving retail customers under the state program.
- Marketer participating in a retail unbundling program can use its released capacity to serve customers who are not subject to the retail access program during periods when the capacity is not needed to serve retail access customers.

Make Sure You Have Fuel to Meet Dispatch Instructions

Entergy Settlement

FERC recently settled with a natural gas fired generator for failing to: 1) procure sufficient natural gas to meet a dispatch instruction, and 2) timely update the ISO of the potential to not meet its dispatch instruction due to a lack of gas.

ISO-NE dispatched gas fired generator. Generator had a large gas account on pipeline. Generator intended to meet its dispatch instruction with: (i) scheduled gas, and (ii) drawing down its pipeline account balance by taking more gas than its scheduled nominations.
Pipeline warns generator it could be limited to scheduled nominations. Generator starts operating, did not change its gas procurement strategy, then notices low pipeline pressure. Generator contacts pipeline which informs generator that it cannot draw down account balance.

Entergy Fuel case (Cont'd)

Generator then informs ISO-NE that it could not meet its dispatch instruction.

FERC said generator should have modified its gas procurement strategy after the pipeline warning. Further, FERC said that generator should have informed ISO-NE of the situation after the initial pipeline warning and at minimum when it noticed that the pressure was low.

General principle from *Entergy* settlement – you should not make an offer if you lack the ability to obtain usable fuel. At a minimum when you determine usable fuel will not be available, tell the ISO/RTO as soon as possible.

QUESTIONS?

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