

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

Dialog Concerning Natural Gas Transportation            )  
Policies Needed to Facilitate Development of            )       Docket No. PL00-1-000  
Competitive Natural Gas Markets                            )

**EXECUTIVE SUMMARY OF  
THE NATURAL GAS SUPPLY ASSOCIATION**

The Natural Gas Supply Association (“NGSA”) shares the Federal Energy Regulatory Commission’s (“Commission”) view that regulation of pipeline affiliate marketers is an important issue. NGSA believes that the problem of how best to regulate pipeline affiliate marketing relationships is one of the central challenges that must be resolved to secure competitive balance in the natural gas industry.

NGSA’s position is that the current code of conduct governing pipeline affiliate marketing operations appears to have been generally helpful in curbing widespread clear violations of existing regulations by pipeline affiliate marketers. That said, now is not the time for a step backward in the Commission’s regulation of pipeline affiliate marketers. Current limitations established by the code of conduct should not be removed or relaxed. The natural gas market has become more complex since 1987. Increasing corporate concentration, shorter-term transactions, negotiated rates and the rise of so-called convergence utilities—utilities engaged in both natural gas and power markets—all contribute to increased market complexity. Greater opportunities exist for pipeline/affiliate discriminatory practices. The code of conduct is needed, now more than ever.

Current reporting requirements are helpful, but not wholly adequate to curtail pipeline/affiliate dealings. Pipelines should be required to report actual usage and non-usage of scheduled capacity. Where a marketing affiliate holds a large share of pipeline capacity, additional data should be required. In addition, bidding procedures should be revised and rate caps for capacity released by a marketing affiliate should be restored. However, no reporting requirements will be effective in the absence of an effective market monitoring program. Finally, if violations are discovered that are found to be egregious by the Commission, the Commission should consider requiring complete structural separation (*i.e.*, divorcement) of a pipeline and its affiliated marketers as a regulatory “last resort” to prevent affiliate abuse.

NGSA requests to participate in the January 31, 2001 conference. For purposes of the conference, NGSA designates as its spokesperson Mark R. Haskell, Co-Managing General Partner, Brunenkant & Haskell, LLP, 805 15<sup>th</sup> Street, N.W., Suite 1101, Washington, D.C. 20005-2289, (202) 4089-0700, E-mail: [haskell@bh-law.com](mailto:haskell@bh-law.com).

NGSA welcomes the opportunity to address the issues identified in these initial comments at the upcoming public conference.

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Dialog Concerning Natural Gas Transportation        )  
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**INITIAL COMMENTS AND REQUEST TO PARTICIPATE OF  
THE NATURAL GAS SUPPLY ASSOCIATION**

In response to the Notice of Staff Conference issued in the docket listed above on November 22, 2000, the Natural Gas Supply Association submits its initial comments<sup>1</sup> and request to participate in the public conference scheduled for January 31, 2001.

**I. Introduction.**

The stated focus of the January 31, 2001 public conference is "whether the regulatory policy with respect to pipeline affiliates and non-affiliates, as well as asset managers and agents, should be revised to reflect the changing nature of the gas market" and "whether there needs to be revisions to the regulations relating to pipeline affiliates."<sup>2</sup>

NGSA shares the Federal Energy Regulatory Commission's ("Commission") view that regulation of pipeline affiliate marketers is an important issue. NGSA believes that the problem of how best to regulate pipeline affiliate marketing relationships is one of the central challenges that must be resolved to secure competitive balance in the natural gas industry.

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<sup>1</sup> NGSA reserves the right to supplement these initial comments, either before or after the scheduled January 31, 2001 public conference. Pursuant to the requirements of the November 22 Notice, a one page single spaced summary of these initial comments is attached hereto.

<sup>2</sup> November 22 Notice, slip op. at 1, *quoting Regulation of Short-Term Natural Gas Transportation Services*, Order No.637, Final Rule FERC Stats. & Regs. Regulations Preambles [Jan.2000-June 2000] ¶ 31,091, at 31,268-69 (Feb.9, 2000); Order No. 637-A, Order on Rehearing, FERC Stats. & Regs. ¶ 31,099 (May 19, 2000).

NGSA represents integrated and independent companies that produce and market domestic natural gas. Established in 1965, NGSA encourages the expanded use of natural gas and a regulatory climate that fosters competitive markets.

NGSA's position is that the current code of conduct governing pipeline affiliate marketing operations appears to have been generally helpful in curbing widespread clear violations of existing regulations by pipeline affiliate marketers. That said, the Commission has identified publicly three instances (cases involving NGPL, K N and Columbia) in which allegations were raised of extensive proscribed affiliate conduct. These examples demonstrate the market dislocations that would result were the Commission to relax the current regulatory regime applicable to pipeline affiliate conduct.

To secure competitive balance and to establish a truly competitive, open national market in the natural gas industry, the Commission must take additional action to address pipeline affiliate marketing relationships. Violations of the code of conduct are difficult to detect even with aggressive monitoring. The code itself governs only organizational separation and communication. The code was issued 13 years ago in a different regulatory environment. Today's natural gas market is more complex. The opportunities for affiliate preference go beyond the narrow scope of the activities banned in the code of conduct. Marketing affiliate preferences exist, as in the case where an affiliated marketer acquires a large portion of the capacity on an affiliated pipeline; however, current rules do not mitigate such preferences in an effective manner. Concerns over marketing affiliate abuses or preferences cannot be measured exclusively by the number of concrete abuses brought to the Commission for enforcement action. It is not necessary to show

that a system is completely dysfunctional before it can be improved. Moreover, structural incentives to discriminate in favor of an affiliate or the perception of inequality can have a real impact on the behavior of competitors. Creative reform of pipeline affiliate marketing regulation can enhance the development of a competitive marketplace.

In the comments below, and at the public conference (should it be granted the opportunity to participate), NGSA will outline the measured program of reform it advocates to enhance the Commission's current regulation of pipeline affiliate marketing relationships.

## **II. Initial Comments.**

### *A. Current Safeguards Establish A Foundation For Further Regulatory Reform.*

Now is not the time for a step backward in the Commission's regulation of pipeline affiliate marketers. Current limitations established by the code of conduct should not be removed or relaxed.

The natural gas market has become more complex since 1987. Increasing corporate concentration, shorter-term transactions, negotiated rates and the rise of so-called convergence utilities—utilities engaged in both natural gas and power markets—all contribute to increased market complexity. Greater opportunities exist for pipeline/affiliate discriminatory practices. The code of conduct is needed, now more than ever.

The existing code of conduct appears to have been helpful in checking widespread violations of existing regulations. However, the abuses that have been detected—in cases involving NGPL, K N and Columbia—show in a clear and direct manner how the natural

gas market could and would be distorted, were the Commission to abandon entirely its currently effective regulatory program.

*B. The Commission Should Expand and Enhance Safeguards Against Affiliate Abuse.*

1. Reporting Requirements.

Current reporting requirements are helpful, but not wholly adequate to curtail pipeline/affiliate dealings. Pipelines should be required to report actual usage and non-usage of scheduled capacity. Where a marketing affiliate holds a large share of pipeline capacity, the following data should be required:

- ❖ The amount of capacity<sup>3</sup> held by others that the marketing affiliate manages;
- ❖ The amount of capacity release from any holder of FT each month by term of release; whether the capacity is sold for more than the maximum rate; and whether it is recallable, with capacity releases by a marketing affiliate separately identified;
- ❖ The amount of capacity released and not recalled during peak periods (*e.g.*, the consecutive three-day peak or some other measure of peak demand periods);
- ❖ The amount of secondary firm capacity at selected delivery points;
- ❖ The amount of secondary firm capacity interrupted each day, and the point(s) of interruption;
- ❖ The amount of gas sold to non-affiliates by the affiliated marketer;
- ❖ The volume of interruptible transportation that was nominated but did not flow; and
- ❖ The amount of the affiliated marketer's primary firm transportation that was nominated and scheduled for the beginning of the day and did not flow (due to re-nomination or any other factor). This requirement is necessary to determine whether a dominant affiliate capacity holder is bumping deliberately competitor deliveries.

2. Market Monitoring.

No reporting requirements—even those outlined above—will be effective in the absence of an effective market monitoring program. Consequently, the Commission should monitor on an ongoing basis a reasonable number (perhaps 200) of critical paths

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<sup>3</sup> As used in this section, the term “capacity” includes mainline capacity and capacity at receipt and delivery points (particularly at points of interconnection with other interstate pipelines).

or critical receipt points on pipelines for the exercise of affiliate market power. In addition, the Commission should devote adequate resources to frequent random audits and other appropriate market monitoring mechanisms to review pipeline/affiliate marketing relationships.

### 3. Infrastructure Improvements.

The Commission should require pipelines expeditiously to install taps to reduce bottlenecks and to construct additional capacity in circumstances in which customers are willing to pay the costs for such expansions.

### 4. Bidding Procedures.

To address concerns regarding preferential treatment of marketing affiliates and market manipulation by marketing affiliates, bidding procedures should be revised to cap the term of affiliated bids at five years.<sup>4</sup> Affiliates should not be permitted to exercise rights of first refusal. Instead, an open season should be held at the expiration of the contract. If a pipeline and an affiliate change the terms of a contract through private negotiations, a new open season should be required, with competitive bidding for available primary pipeline capacity.

### 5. Rate Caps.

Where a marketing affiliate controls a large portion of capacity on a given pipeline system, rate caps for capacity released by a marketing affiliate should be restored. This solution addresses in part the structural advantages enjoyed by pipeline affiliate marketers. The Commission to date has not yet come to grips with this issue. The Commission has assumed that pipeline marketing affiliates would have no economic

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<sup>4</sup> See Request of the Natural Gas Supply Association for Rehearing of Order No. 637, Docket Nos. RM98-10-000, *et al.*, at 19-20 (March 10, 2000).

incentive to withhold the capacity that they can acquire more readily by virtue of their affiliation. NGSAs believe this assumption is incorrect. The assumption rests on the belief that capacity release and interruptible transportation are both good alternatives for capacity held by the marketing affiliate. Both capacity release and interruptible transportation are subject to disruption by the conduct of the marketing affiliate/capacity holder itself. Neither may be a good alternative, as a result. Further, this belief is supported by a flawed notion that opportunity costs will be sufficient to deter pipeline affiliate abuse in all cases.

#### 6. Structural Separation.

If violations are discovered that are found to be egregious by the Commission, the Commission should consider requiring complete structural separation (*i.e.*, divorcement) of a pipeline and its affiliated marketers as a regulatory “last resort” to prevent affiliate abuse.

### **III. Proposed Questions to Panelists.**

NGSA proposes that the appropriate panelists address the following questions:

- A. Do pipeline marketing affiliates hold substantially more capacity on their affiliated or “home” pipelines than they do on unaffiliated pipelines? Are there advantages to having an affiliate hold capacity, rather than an unaffiliated shipper?
- B. Explain why the existing code of conduct can be considered unfair or burdensome.
- C. To what extent would corporate profitability be reduced if pipeline affiliates were prohibited from doing business on affiliated pipelines?
- D. To what extent would pipelines be willing to accept changes in the way capacity allocation is performed to mitigate shipper concerns about affiliate capacity holdings?

#### **IV. Request to Participate; Designation of Spokesperson.**

NGSA requests to participate in the January 31, 2001 conference. For purposes of the January 31, 2001 conference, NGSA designates as its spokesperson Mark R. Haskell, Co-Managing General Partner, Brunenkant & Haskell, LLP. Mr. Haskell has extensive experience in natural gas regulatory matters before the Commission on behalf of natural gas producers and others, and directly with NGSA.

In compliance with the November 22 Notice, NGSA provides the name and address of its contact person, telephone number and e-mail address:

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**V. Conclusion.**

NGSA welcomes the opportunity to address the issues identified in these initial comments at the upcoming public conference.

Respectfully submitted,

**NATURAL GAS SUPPLY ASSOCIATION**

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By:

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Patricia W. Jagtiani  
**Director of Regulatory Affairs**  
**Natural Gas Supply Association**

DATED: January 5, 2001

**CERTIFICATE OF SERVICE**

Pursuant to Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010 (2000), I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 5<sup>th</sup> day of January 2001.

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