

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

San Diego Gas & Electric Company)

Docket No. RP01-180-000

Motion to Intervene and Protest of the Natural Gas Supply Association

Pursuant to Rules 211 and 214 of the Federal Energy Regulatory Commission's Rules of Practice and Procedure, 18 C.F.R., ' ' 385.211 and -214 (1999), the Natural Gas Supply Association (NGSA) requests intervenor status in this proceeding and protests San Diego Gas and Electric's (SDG&E) request that regulatory limitations be put in place on sales of natural gas at the California border and to points of interconnection between interstate pipelines and California local distribution companies (LDCs). As a representative of major domestic producers of natural gas, NGSA is concerned that the requests made by SDG&E, even if legally permissible, stand to adversely impact the market signals to producers at a time in which it is vital to our country's energy needs that accurate market signals remain in place.

We understand that the current market conditions in the natural gas markets, especially in California, are frustrating to consumers. Consumers deserve reliable gas service at prices that appropriately balance supply and demand, thus ensuring economic viability of continued utilization of natural gas. Obviously, producers want natural gas to remain an affordable product.

However, as Congress, and subsequently the Commission have found, placing regulatory limitations on a highly competitive commodity market such as the market for natural gas is not the answer. Indeed, the best guarantor of consumer protection is a competitive marketplace, such as the one that exists in natural gas production.

NGSA Does Not Oppose SDG&E=s Proposal to Reimpose Price Caps for Short-Term Releases of Transportation Capacity

As stated in NGSA=s Request for Rehearing of Order No. 637, we do not believe it was appropriate to lift price caps for short-term secondary market transactions without either finding an absence of market power, or by imposing conditions to mitigate the market power that can be exercised by pipelines acting in conjunction with their affiliates. In Order No. 637, the Commission asserted that Athe removal of the rate cap for capacity release transactions does not effectively change the status quo, since the value of transportation in the bundled sales market can exceed maximum tariff-based rates.@ Order at 85. NGSA disagreed with this conclusion and stated that the secondary transportation market *does* matter B citing the fact that upstream gas suppliers need to purchase short-term released capacity to transport gas to downstream market centers or other destinations and lifting the cap allows shippers to extract rates above maximum tariff rates. NGSA comments at 9.

Also, in our comments, NGSA urged the Commission that, if it proceeded with its experiment to lift price caps for short-term capacity releases, certain safeguards should be in place to lessen the ability of pipelines and their affiliates to use their market power, including

requiring pipelines to build additional capacity when requested by customers willing to pay the costs of construction. Additionally, NGSAs encouraged the Commission to strongly consider limiting the rate at which an affiliate can release capacity and limiting the amount of capacity an affiliate can hold. NGSAs Comments at 15. Thus, NGSAs understands SDG&Es concern that the market for pipeline transportation is not sufficiently competitive nor is market power sufficiently mitigated to allow for the lifting of the price cap for releases of capacity. Obviously, the differentials that are now prevalent in the California market are evidence that transportation in that market is scarce and that some of those holding pipeline capacity may have the ability to exert market power in the secondary market for transportation.

For these reasons, NGSAs does not oppose SDG&Es request that the price cap for short-term capacity release transactions be reimposed. However, given that much of the recent market activity in California has not been a function of the release of transportation capacity, we would not expect that, in this instance, significant relief would be provided to consumers by this proposed action.

Regulatory Constraints on Bundled Sales Could Have Serious Adverse Consequences on the Natural Gas Market

Unlike the market for interstate transportation capacity, the natural gas commodity market is extremely competitive. There are more than 8,000 producers of natural gas with the top five producers supplying only 23% of the countrys market demand. Recent market volatility has created a great deal of concern but this concern regarding current market conditions needs to be

put in perspective. Over the last two decades, the natural gas market has been a tremendous success in terms of reliability and price through the operation of a free market. In short, there is substantial evidence proving that the market pricing for the natural gas commodity works.

Citing recent market volatility in the California energy markets, SDG&E has requested that sellers be required to state separately the transportation and commodity components of the bundled rate for natural gas sales at the California border and at points of interconnection between interstate pipelines and California LDCs. Alternatively, SDG&E requests that a cap be created for bundled sales by capping border prices in California at 150% of the sum of a reported average commodity sales price plus the as-billed rate for interstate transportation. Both of these proposals attempt to isolate the transportation component from the border price by deducting the value of transportation from the total sales price. Unfortunately, it is not that simple.

Under SDG&E's alternative proposal, arbitrary assumptions are made in order to create a cost-based cap for the transportation value portion of the border price and a cap on gas sales is arbitrarily placed at 150% of an average price in the field. Assuming, *arguendo*, that SDG&E's requests are legally permissible, given that natural gas transactions consist of bilateral *over-the-counter* deals that are negotiated among countless participants, we question, as a general matter of practicality, specifically how SDG&E's request, could be applied. For example, how can one accurately determine an average price in the field? Would field prices be weighted by some particular volume? How do you account for the daisy-chain of transactions that occur among a multitude of market participants? Would the transportation value of the border price be assumed

to be at a maximum rate?

NGSA is concerned that if price signals are manipulated in this manner, no mechanisms will be in place to provide producers with the ability to recognize imbalances in market supply and demand. There is no doubt that imposing regulatory limitations on sellers of natural gas will inherently hinder the ability of the market to sort itself out B regardless of whether that sale is made at the wellhead or at the California border. We are sympathetic to SDG&E=s concerns regarding the transportation value included in the border price but on balance, we believe that the risk of affecting the commodity portion of the border price would ultimately cause more harm to the market B by sending inaccurate market signals at a time when increased production is vital to our country=s energy needs.

California=s Energy Situation is Manifested by Number of Contributing Factors Related to that Region

To put the recent California market volatility in perspective, we think some clarifications to SDG&E=s request are needed. SDG&E states that the commodity price at the California-Arizona border has risen from less that \$6 per MMBtu in November to over \$50 per MMBtu. However, the daily spot price does not apply to all volumes transacted in the California market. The gas market is made up of two markets: a Afirst of the month@ (FOM) market and a Adaily@ market, with the daily market being much more volatile B creating a greater potential for highs and lows in the price for gas. Although no public data is available regarding the number of trades that are made in the daily market relative to the FOM market, it can be assumed that many

more deals are made in the FOM market by customers that wish to limit the amount of volatility they may experience during the month.¹ Additionally, some purchasers hold long-haul transportation contracts and have the ability to purchase their gas in the production areas at rates that are at or near the published indices for those basins. Thus, assumptions that a vast portion of the market is subject to the recent market volatility is, at the very least, questionable.

When assessing the current situation in California, it is important to examine the factors that may have contributed to the tightness of the natural gas market. For example, storage levels may have been impacted by increased withdrawals following the El Paso explosion that occurred in August B which is typically the time in which gas is injected into storage. Additionally, unlike the assertions that have been made relative to productive capacity on the electric side, the fact that the pipelines bringing gas from the production areas into California are running at full capacity is evidence that production is not being withheld. Rather, pipeline capacity constraints need to be eliminated. Given that several pipelines have responded to the market by submitting proposals to the Commission to expand the amount of capacity into California, NGSa strongly encourages the Commission to expeditiously complete the certificate review process and authorize those projects that can add much needed capacity into California.

¹ The American Gas Association's report entitled "LDC System Operations & Supply Portfolio Management During the 1999-2000 Winter Heating Season" finds that, on average, spot market purchases accounted for 9% of LDC peak day purchases.

Longer-term solutions, such as advancing a balanced energy policy that includes increased access to natural gas resources, also will greatly assist in alleviating the type of market conditions we see today.

Producers are Responding to the Market

With tight supply and rising demand, producers are individually responding to market signals by working to bring more natural gas to the market. One economic indicator to determine producer response to the market is the Rotary Rig Count. Natural gas rigs drilling new wells have increased over 130% since April 1999, when prices were at their lowest. As of December 11, 2000, there are 844 rigs drilling for natural gas. Equally important, approximately 80% of the rigs being used today are looking for natural gas, up from 75% in April 1999.

Well completions, another measure of exploration and production activity, are up almost 48% in 2000 over those completed in 1999. For the first ten months of this year, a total of 12,227 natural gas wells were completed as compared to 8,267 wells for the same period last year (1999). Moreover, producers are actively trying to address the lead time that exists to bring new wells on line. These include hiring more workers, building new drill rigs, and using new technology to speed up the drilling process.

Capital expenditures for exploration and production activities are also on the rise. Analysts estimate that corporate budgets for exploration and production will increase by 20-40% in 2001, as producers continue to increase drilling to bring new natural gas supplies to the

market. According to estimates made in by the National Petroleum Council, \$658 billion will need to be invested in E&P between 1999 and 2015.

We recognize that SDG&E=s request is circumscribed to include only those points in California. Yet, any endeavor to re-control the price of gas could unnecessarily lead to adverse market consequences. History has proved this to be so.

Wherefore, for the reasons stated above, NGSA urges the Commission to reject SDG&E=s request to impose any form of regulatory limitations on the border price for natural gas in California.

Respectfully Submitted,

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