

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

**Natural Gas Pipeline Negotiated Rate
Policies and Practices**)

Docket No. PL02-6-001

**REQUEST FOR CLARIFICATION
OF THE NATURAL GAS SUPPLY ASSOCIATION**

Pursuant to Rule 212 of the Federal Energy Regulatory Commission's ("Commission") Rules of Practice and Procedure, the Natural Gas Supply Association ("NGSA") hereby respectfully requests clarification regarding the Commission's January 19, 2006 Order on Rehearing and Clarification issued in the captioned docket.¹ NGSA is submitting this filing in light of significant policy concerns arising from the Commission's decision to allow pipelines to enter into negotiated rate agreements utilizing basis differentials as a transportation pricing mechanism. NGSA avers that the Commission's January 19 Order raises several new issues requiring further clarification by the Commission.

I. STATEMENT OF ISSUES

1. The Commission should clarify what methodology pipelines should use to evaluate bids for capacity made available at an index-based rate.
2. The Commission should commit to report on its monitoring of the new policy allowing negotiated rate agreements based on basis differentials after a set period of time.
3. The Commission should require the same level of transparency and pipeline reporting with regard to index-based discount transactions as it has for index-based negotiated rate transactions.
4. The Commission should confirm that its policies allow index-based pricing capped at the maximum rate for secondary market transactions.

¹ *Natural Gas Pipeline Negotiated Rate Policies and Practices*, 114 FERC ¶ 61,042 (2006)(herein "January 19 Order").

II. REQUEST FOR CLARIFICATION

The Commission first authorized pipelines to enter into negotiated rate agreements in 1996.² From the outset, the Commission has always recognized the importance of protecting shippers from the exercise of pipeline market power by requiring the pipeline to maintain a cost-based recourse rate, thereby “assuring that the customer always has the option of purchasing capacity at the just and reasonable tariff rate.”³ In 2003, the Commission revised its negotiated rate policies by prohibiting negotiated rate agreements with rates based on basis differentials.⁴ At the time, the Commission was concerned that such negotiated rate agreements “could provide pipelines with an incentive to withhold capacity in an attempt to manipulate the gas commodity market to widen the differences between the relevant price indices.”⁵ After reconsideration, however, the Commission now has determined that “the ability of pipelines to manipulate the gas commodity market is tempered by several factors”⁶ and the benefits of utilizing basis differentials to set negotiated rates mitigates against any potential harm.

NGSA does not here take a position on the Commission’s ultimate decision in the January 19 Order authorizing the use of basis differentials as a transportation pricing mechanism in negotiated rate deals. Instead, NGSA believes that the Commission’s January 19 Order raises several questions regarding the fairness, transparency and competitiveness of the new policy and the treatment of discount and capacity release transactions, and thus requests clarification of the

² *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, Regulation of Negotiated Transportation Services*, 74 FERC ¶ 61,076, *order on clarification*, 74 FERC ¶ 61,194, *order on reh’g*, 75 FERC ¶ 61,024 (1996).

³ January 19 Order at P 2.

⁴ *Natural Gas Pipeline Negotiated Rates Policies and Practices*, 104 FERC ¶ 61,134 (2003)(herein “July 2003 Order”).

⁵ January 19 Order at P 3.

⁶ *Id.* at P 10.

Commission's January 19 Order to further its objectives of a more competitive and transparent gas market.

A. The Commission should clarify the appropriate methodology pipelines must use to evaluate bids on capacity made available at index-based prices, or in the alternative require each pipeline to file a suggested methodology.

NGSA takes this opportunity to bring to the Commission's attention the fact that pipelines existing tariffs are unclear on the appropriate methodology that pipelines will use to evaluate bids on available capacity based on index prices. Previously, the Commission has spent considerable efforts streamlining the pipelines' bid evaluation process and many shippers have contributed to the development of those standards. Unfortunately with the Commission's allowance of index-based rate agreements, the pipelines' tariffs no longer contain adequate, known procedures. Therefore, NGSA respectfully requests the Commission to identify the appropriate methodology by which pipelines will evaluate index-based bids. In the alternative, NGSA requests that the Commission require pipelines to file with FERC a proposed methodology. In this way, all shippers can be assured that the pipelines are transparent and act in a non-discriminatory manner in evaluating bids for capacity available at an index price.

Such action is particularly important in view of the fact that the future revenue to be generated for the pipeline under an index-based deal is, by its very nature, unknown and speculative. Since the Commission's current policy is that only known or guaranteed revenue can be used in assessing the value of a bid, it is vitally important for the industry to know how an index-based arrangement will be valued in comparison with one where the value can be easily ascertained.

B. The Commission should monitor its new policy and issue a report after one year.

In allowing negotiated rate agreements to be based on basis differentials, the Commission emphasized in its January 19 Order that pipelines' ability to manipulate the commodity market is "tempered" by the existence and availability of information and data thus promoting transparency with regard to negotiated rate deals. The Commission specifically noted that because pipelines are required to file all negotiated rate agreements with the Commission for approval and daily basis differentials data is accessible, it will have a greater ability to "monitor the transactions to determine if the pipeline is withholding capacity in order to increase the gas commodity basis differential."⁷

NGSA urges the Commission to use the data available to it, as well as the negotiated rate agreements filed with the Commission, to actively monitor the implementation of this modification to its negotiated rate policy. Moreover, NGSA also requests the Commission to issue a public report after the new modified policy has been in place for one year. Such report would review the use of basis differentials as a pricing mechanism for negotiated rate agreements, specifically considering the effectiveness of the mitigation measures cited by the Commission that "temper" the pipelines' potential manipulation of the gas market. In this way, the Commission can ensure that the use of basis differentials as a pricing mechanism is transparent and not being abused to manipulate the natural gas commodity market.

C. The Commission must require a similar level of transparency with regard to discount agreements and negotiated rate agreements.

NGSA agrees with the Commission's intent to utilize the filed negotiated rate agreements to ensure that its new policy is functioning properly. Such transparency fosters market

⁷ *Id.*

competition. NGSAs are concerned, however, that a similar level of transparency currently does not exist with regard to index-based discount agreements and requests the Commission to adopt a similar policy or provide some other means to ensure an equivalent degree of transparency and competition.

As the Commission is aware, pipelines are able to enter into index-based, discount rate transactions.⁸ While negotiated rate deals will remain transparent under the new policy given that all such agreements must be filed with the Commission no later than the date on which gas begins to flow under the contract, the same is not true for index-based discount rate agreements. For index-based, discount rate transactions, it appears that interested parties cannot ascertain from the required postings the index formula used to achieve these discounts. Rather the postings only set forth the actual rate that results from the calculation of the formula. For example, while the Standards of Conduct Final Rule (Order 2004) promoted transparency by requiring that pipelines post discount rate transactions “contemporaneously with the time that the offer is contractually binding,”⁹ pipelines have failed to interpret such mandated transparency as requiring transparency of index methodologies. This makes it difficult therefore to assess whether such agreements further the competitive market or results in market manipulation. Transparency of index-based discount methodologies also would allow the Commission further

⁸ *Northern Natural Gas Co.*, 105 FERC ¶ 61,299 (2003).

⁹ *Standards of Conduct for Transmission Providers*, Order No. 2004-C, 109 FERC ¶ 61,325 at P 40 (2004). *Standards of Conduct for Transmission Providers*, III FERC Stats. & Regs., Regs. Preambles ¶ 31,155 (2003) (Order No. 2004), *order on reh'g*, III FERC Stats. & Regs., Regs. Preambles ¶ 31,161 (Order No. 2004-A), *order on reh'g*, 108 FERC ¶ 61,118 (Order No. 2004-B), *order on reh'g*, 109 FERC ¶ 61,325 (2004) (Order No. 2004-C), *order on reh'g*, 110 FERC ¶ 61,320 (2005) (Order No. 2004-D), *appeal docketed sub nom. National Fuel Gas Supply Corp., et al. v. FERC*, Nos. 04-1183, et al. (D.C. Cir. June 9, 2004 and later).

means to monitor whether the mitigation measures cited in the January 19 Order actually do “temper” potential manipulation of the gas market.

In order to have congruity between index-based negotiated rates and index-based discount rates, NGSAs requests the Commission to provide the same transparency for discount deals based on basis differentials as is provided for negotiated rates.

The need for transparency is also important inasmuch as pipelines could manipulate the value of their capacity even where that value is below the maximum rate. The availability of a maximum rate recourse option does nothing to protect a shipper in that instance. Manipulation is just as injurious if it results in the artificial inflation of transportation costs below the maximum rate as it would be if the resulting rate exceeded the maximum rate.

D. The Commission should confirm that nothing in its new policy restricts index-based pricing capped at maximum tariff rates for secondary market transactions.

As the Commission has modified and further developed its negotiated and discount rate policies, NGSAs believes that certain clarification is needed from the Commission with regard to capacity release transactions to ensure a fair and competitive secondary market. Notably, NGSAs requests that the Commission confirm that there is nothing in its new policy or in existing regulations that would restrict a capacity release based on an index price, e.g., a basis differential, as long as the rate does not exceed the maximum tariff rate. The Commission has indicated that a releasing shipper should be free to offer the same type of pricing arrangements that the pipeline offers,¹⁰ yet most releasing shippers cannot do this because most pipelines, and the current NAESB data sets, do not support these types of transactions. While pipelines may not have adequate internal procedures to support such a transaction and may prefer maximum-

¹⁰ *Panhandle Eastern Pipe Line Company, LLC*, 106 FERC ¶ 61,194 (2004).

rate or fixed-price bids, NGSA nonetheless believes that this does not mean that such a secondary market transaction is impermissible. NGSA asserts that in order to ensure a truly competitive market and comparability among various options to secure pipeline capacity, such flexibility is required and respectfully urges the Commission to endorse policies and procedures that support index-based deals in the secondary market. Additionally, the Commission should encourage NAESB to establish the needed data sets to allow for shippers to release capacity under the maximum rate based on gas price indices.

III. CONCLUSION

WHEREFORE, in consideration of the foregoing, the Natural Gas Supply Association respectfully requests that the Commission provide the clarification or grant rehearing consistent with the above pleading.

Respectfully submitted,



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