UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Developments in Natural Gas Index Liquidity and Transparency	**Docket No. AD17-12-000**
Price Discovery in Natural Gas and Electric Markets	**Docket No. PL03-3-000**
Natural Gas Price Formation	**Docket No. AD03-7-000**

COMMENTS OF THE NATURAL GAS SUPPLY ASSOCIATION

Pursuant to the Federal Energy Regulatory Commission ("FERC" or "Commission") staff invitation to provide comments in the above referenced proceedings, the Natural Gas Supply Association ("NGSA") respectfully submits the following comments in responses to the discussion at the FERC staff-led June 29, 2017 Technical Conference on Developments in Natural Gas Index Liquidity and Transparency (Docket No. AD17-12-000), Price Discovery in Natural Gas and Electric Markets (Docket No. PL03-3-000) and Natural Gas Price Formation (Docket No. AD03-7-000) ("Technical Conference"). NGSA participated in the Technical Conference Panel 2 discussion regarding the role of natural gas indices in price formation.

NGSA represents integrated and independent energy companies that produce and market domestic natural gas. Established in 1965, NGSA encourages the use of natural gas within a balanced national energy policy and supports the benefits of competitive markets. NGSA members trade, transact and invest in the U.S. natural gas market in a range of different manners. Some NGSA members price report and some do not; however, three of the five largest companies that report are NGSA members. Thus, NGSA has a direct interest in these proceedings.

I. CONFIDENCE

NGSA member companies and countless natural gas consumers invest billions of dollars annually in the natural gas market through commodity sales and purchases, production investment, pipeline and midstream infrastructure and end-use technology. NGSA members have the confidence to make these investments because the natural gas market exhibits three characteristics of health -- transparency, efficiency and integrity.

More specifically, NGSA has confidence both in the indices by which its members buy and sell natural gas in the U.S. and in the mechanisms that the market provides to ensure that the indices continue to be robust. The indices are an accurate representation of the price at which sellers and buyers agree to transact and thus represent the market value for the natural gas traded. Importantly, the indices are one of many tools contributing to natural gas market transparency and facilitating sound transaction decision-making. Independent corporate assessments of underlying fundamentals must remain at the heart of natural gas transaction decisions regardless of whether the transaction is done at a fixed price, at index or at a hybrid of the two.

The Technical Conference highlighted the declining trend in the level of pricing reporting as evidenced by the FERC Form 552 data and the heightened regulatory risk that this trend places on market participants that choose to price report. As referenced during the Technical Conference and shown below, the S&P Global Platts' analysis of the FERC Form 552 data found an increase in reportable volumes between 2015 and 2016 and that the majority of the increase in reportable transactions came from market participants that do not price report.[1] Analysis of the FERC Form 552 data also reveals that market participants' reliance on the indices for transaction pricing also increased. A couple of important observations can be made from these findings.

Biggest Movers In 2016 (Corporate Level)

#	Company Name	2016 Total Volume	2015 Total Volume	Annual Change	Price Reporter?
1	Mercuria	1.720.6	725.9	994.7	No
2	Tenaska	5,350.5	4,418.1	932.4	Yes
3	Twin Eagle	1,947.1	1,432.1	515.0	No
4	Direct Energy	1,596.8	1,157.2	439.6	No
5	Antero Resources	1,015.3	575.8	439.5	No
6	Vitol	732.2	325.2	407.1	No
7	Cheniere Energy	404.8	12.1	392.7	No
8	Morgan Stanley	598.7	221.6	377.1	No
9	Koch Industries	1,244.3	886.6	357.7	No
10	DTE Energy	1,547.1	1,218.3	328.8	No

- Majority of largest yearly volume increases by non-price reporters

Source: FERC 552 data

S&P Global
Platts

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First, **increased reliance on the indices suggests continued market participant confidence in the indices.** Indeed, market participants have vast, almost real-time

[1] NGSA members supply about one-quarter of the U.S. natural gas produced and are not among the "Biggest Movers in 2016."

fundamentals information on which to base sound transaction decisions. The fact that market participants choose to rely on the indices for billions of dollars in natural gas market transactions is a resounding indicator of confidence that is amplified by the unrivaled level of market transparency characteristic of the U.S. natural gas market. The 10+ year old FERC framework for good faith price reporting and publishing succeeded in restoring market confidence in the indices that remains evident today.

Reliance on the indices indicates confidence in the indices. Although not the case today, if the indices were perceived to be out-of-step with underlying fundamentals data, the high level of natural gas market transparency would make that fact obvious to market participants and would trigger a market response to correct the calculation behind the index, cease reliance on the index or increase reporting. The market response to increase the level of data behind the indices is far more efficient when the decision to price report and price reporting itself is simple and without regulatory risk. Consumers benefit when regulatory barriers to the market decision to price report are minimized to allow the self-correcting nature of the market to work.

Second, **the decision not to price report by many of the entities with the largest increases in marketed volumes in 2016 may suggest that the perceived or real cost of price reporting outweighs the benefit.** There are different points of view regarding an individual corporate decision to report prices to index publishers or not. It essentially boils down to an individual corporate assessment of regulatory risk versus the commercial risk that may stem from reliance on indices that are derived only from the transaction data of other companies.

II. REGULATORY RISK

The indisputable fact that the largest transaction volume increases between 2015 and 2016 stem from non-price reporters is indicative of a more nuanced trend that also surfaced during the Technical Conference and that hits the heart of the regulatory risk concerns that were the center of many of the points made. In short, the largest price reporters comprise an increasing percent of the data used to support the indices.[2] Specifically, the largest 5 price reporters' data comprised more than 53 percent of the volumes used to set the daily indices in 2016 compared to 37 percent in 2012, and more than 55 percent of the volumes used to set the monthly indices in 2016 compared to 45 percent in 2012. This **highlights the vulnerability of the volume-weighted average approach to index creation, <u>and</u> underscores the regulatory risk for those entities whose transaction data accounts for what has been a growing share of the data contributing to the publishers' indices.**

If a company believes its transaction data may be a significant amount of the data at a particular trading location, the fear of regulatory "hindsight" scrutiny and second-guessing around the motivations for other physical and financial market transactions is likely to increase. The rigor, cost and time necessary for a company to assure

[2] The term "index liquidity" was often used during the Technical Conference to describe the volume and number of transactions data used to develop the volume-weighted average published indices. Transaction liquidity concept is broader and separate but equally important.

compliance and protect itself from potential reputational damage is significant. This is true even if a company is cleared after a regulator's investigation of *possible* wrong doing. Price reporters not only depend on a market that is free of manipulation, they stake their reputations on ensuring data for the creation of volume weighted price indices. Clearly, they have made the very tough cost-benefit evaluation and determined that the business reasons for contributing to the indices on which they rely outweigh the regulatory risk. As the concentration in the price reporting increases, the regulatory risk side of the fragile cost-benefit equation also grows.

Indices and the level of transparency in healthy markets will always evolve as technology and businesses change. Platts' acquisition of the ICE transaction data is a market response and one that may very well help address this concentration issue because it is expected to increase the volume of data (the denominator) on which the volume-weighted average indices are based. NGI has incorporated ICE data into its published indices for years. NGSA is supportive of including ICE transactions in the reporting process as long as this does not increase compliance risk for its member companies.

Price reporting is voluntary and the NGSA firmly believes that the voluntary nature of the price reporting process must be maintained, despite the recent decline in foundational data reflected in the 2016 FERC Form 552s. The voluntary approach works. It allows the different entities in the marketplace to take appropriate measures to ensure they receive fair value for the natural gas they are buying and selling. If FERC was to remove this fundamental voluntary approach, it would risk the unintended consequences of fewer executed fixed price trades and undermining a well-functioning and reliable market pricing mechanism.

Despite the concentration trend, the freedom to decide to price report or not must remain voluntary so that a regulatory distortion in transaction decisions can be avoided. In a healthy market, transaction and pricing decisions must be based on individual assessments of market fundamentals. Transaction decisions cannot be distorted by regulatory mandates without risk to "transaction liquidity" which is discussed more fully below. The decision to report or not varies by company and appropriately rests with the company's management. Making reporting mandatory could also be futile if it drove more companies to transact at index rather than at fixed prices.

Transaction liquidity, which is most commonly referred to simply as "liquidity" or "market liquidity," was also discussed during the Technical Conference and was perhaps at times confused with references to "index liquidity," which is intended to refer to the robustness of reported transaction data that supports index publisher volume-weighted indices.

Liquidity "describes the sensitivity of [the market clearing] price to trading."[3] It is important to note that at any point in time, the market clearing price, which is the price at which a willing buyer and seller agree to transact, is different from and in fact may or may not be consistent with the publishers' index price. Perhaps most importantly, however, market participant reliance on the indices, notwithstanding access to vast underlying fundamentals data, suggests that the indices are well-aligned with individual corporate views of a just and reasonable market price.

Over the last decade, liquidity levels at different geographical locations have changed. Changes in liquidity can stem from a variety of reasons, such as new sources of supply, infrastructure changes and new points of sale. For instance, the shale revolution has dramatically altered physical natural gas markets. As an example, because of the growth in shale production from the Utica and Marcellus, natural gas supplies available in the Mid-Atlantic now exceed the highest daily supply levels from the U.S. Gulf Coast and Gulf of Mexico off-shore more than a decade ago. The Mid-Atlantic natural gas market has gone from being a net center for demand to being a net center for supply. This change has impacted liquidity in the Mid-Atlantic but also in other regions. Another key change in the market from a decade ago that is also a direct result of the shale revolution and related infrastructure enhancements is a flattening in the regional and seasonal natural gas pricing differentials across much of the U.S. In

[3] See "Natural Gas Price Transparency and Liquidity" paper by Peter Locke for NGSA, p. 2 available on the NGSA website at http://www.ngsa.org/download/Natural-Gas-Price-Transparency-and-Liquidity.pdf.

short, geographical changes in U.S. natural gas supply and demand patterns coupled with less regional and seasonal variation in the pricing have changed locational liquidity.

Regulatory changes also are likely to have impacted liquidity over the last decade. It is difficult to isolate the cause of observed liquidity changes as being caused or driven by one factor or another. The bottom line is that there are fewer market participants doing fewer transactions at some locations and more at others. Liquidity constantly changes. While overarching market confidence remains, the reality of declining liquidity at some locations likely exacerbates the perceived regulatory risk for price reporters transacting at those locations.[4]

A regulatory mandate for price reporting may result in a disincentive for engaging in reportable/fixed price transactions. Put simply, mandating that companies price report their fixed price transactions may drive some entities to avoid those types of transactions. This would have the perverse effect of negatively impacting the normal functioning of the market by limiting liquidity.

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[4]Taking the discussion of liquidity a step further, less physical market liquidity, regardless of whether the change is market-wide or regional, often translates to higher transaction costs because the pricing risk (*i.e.* the bid-ask spread) increases. As physical market price risk increases, hedging needs increase so that access to affordable capital can be maintained. This financial market liquidity issue also surfaced at the Technical Conference. If financial market liquidity is also limited, hedging becomes more costly, the cost of capital increases and that translates to less capital available for investment and increases consumer costs. NGSA has actively worked for the last decade to ensure market participant ability to cost-effectively hedge through extensive advocacy surrounding the passage and Commodity Futures Trading Commission ("CFTC") implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Liquidity, hedging and capital investments are intertwined.

Market participants must have the flexibility to make transacting decisions based on their independent assessment of underlying fundamentals. This is a self-correcting characteristic that is inherent in a healthy market – **a variety of transaction alternatives, data sources and the freedom to choose where, when and how to transact, along with the freedom to decide if price reporting is or is not the right corporate decision is critical to market health and efficiency**.

Companies that report do so because they believe their reportable fixed price transactions contribute to the accuracy of the indices. Such companies have undoubtedly made the decision that the value of their contribution to the indices outweighs the cost of managing and submitting the data. **The tipping point differs for each company but likely centers on the volume of reportable data and the availability of the human and technical resources to soundly and affordably implement FERC's good-faith price reporting guidelines, and confidently enter into the confidentiality agreements with the index publishers.**

The concept of requiring companies to report prices to *all* index publishers if the company reports prices to *one* index publisher also surfaced at the Technical Conference. Companies choose to report to different index publishers for a variety of reasons creating competition among index publishers. Competition among price reporters is an important part of the healthy market. Competition among index publishers encourages efficiency and provides transparency options – different perspectives on the market and alternatives for price reporters.

III. SUGGESTIONS

Undoubtedly, the reporting process comes with both cost and risk. Thus, it is important that the FERC does all it can to minimize the costs and risks inherent in the price reporting process so that regulation does not become a barrier to price reporting. Price reporting policies must be as clear, simple and sound as possible with minimal regulatory risk for inadvertent errors for price reporters. Price reporters *are* market participants who also want and depend on a sound market.

The monthly and daily physical natural gas markets are different, distinct product markets. Daily market transactions are for the purchase or sale the "next day"[5] of a defined volume of natural gas at an agreed upon location. Monthly market transactions are for the purchase or sale of a defined, uniform volume of natural gas at an agreed upon location *every day* during the subsequent calendar month. Although both markets involve the sale of natural gas, the "product" is vastly different – one is a day's worth of natural gas while the other is an even volume of natural gas every day for the subsequent month.

Corporate strategies differ in terms of how the two different markets are used, and it is not uncommon for different companies to use one market more extensively than the other simply because of unique business needs. For this reason, the cost – benefit balance of price reporting transactions in either the daily or the monthly markets

[5]Next Day may also include weekends and holidays.

may differ from the cost – benefit balance for price reporting transactions in both markets. Market participants should be permitted to price report in either the daily or monthly market without risk that doing so may be considered by FERC as "selective" reporting. **FERC's interpretation of the policy statement should not treat the markets as if they are the same by considering a corporate decision to price report transactions in either the daily or monthly market, but not both, selective reporting and a violation of the FERC price reporting guidelines.**

Additionally, a few thoughtful changes in the safe harbor standards could reduce the costs. Price reporting demands resources for monthly and annual reporting as well as staffing for the annual independent audit requirement. Systems and controls are required to generate and submit reports. Each of these steps takes time, costs money and involves risk. **The cost of the annual self-audit requirement could be cut by half if the audit requirement were simply changed to an every-other-year requirement.**

Further, onerous and lengthy FERC audit processes of companies that voluntarily report are of significant concern. Industry experience is that FERC audits often last more than a year with countless company man hours dedicated to the FERC staff scrutiny of inadvertent, clerical errors that represent a de minimis amount of the data reported to index publishers with no impact on the published index.

Importantly, the FERC staff audit process should not be a market oversight tool or a proxy for sound market oversight. An open audit may be disclosed in company financial statements, thus the "cost" goes well beyond man hours to include corporate reputational risk and thus, enterprise value. **FERC audit processes should be efficient and consistent with the timing required for a standard independent financial statement audit, and FERC staff should rely on price reporter certifications or clean self-audit reports to make the FERC audit process more efficient and less duplicative.** The price reporter independent audit, conducted in a manner that follows generally accepted auditing standards,[6] is a tenet of FERC's price reporting safe harbor. As a tenet of the safe harbor, it should adequately assure FERC staff of the company's adherence to the price reporting guidelines.

We would encourage FERC to be cognizant of its actions or behaviors that might inhibit market participation and liquidity. Given recent experience with the audit process, the safe harbor mechanism is not sufficiently defined to allow reporting entities to believe that they will not be unduly punished for innocent, clerical errors. A well-structured and genuine safe harbor and a fit-for- purpose, focused audit process would be useful in encouraging more market participants to report fixed price trades and, importantly, encouraging those market participants that currently report to continue to do so.

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[6] Such as those prescribed by the Institute of Internal Auditors or other similar generally accepted auditing standard, as long as the internal audit personnel are independent from the trading and reporting departments and personnel.

CONCLUSION

Published indices are just one of many market transparency tools. In addition to the published indices, market participants have access to near real-time data regarding underlying supply and demand fundamentals, flow capacity and constraints. It is the availability of diverse and timely information that supports the informed decision-making behind natural gas transactions.

Natural gas markets are highly evolved, which provides an added transparency benefit for consumers and market participants. We cannot burden the process of voluntary price reporting with unmanageable compliance and regulatory risk and expect the benefit to last. Likewise we cannot inject regulatory distortions into transaction decisions and expect the natural gas market to continue to reflect changes in underlying fundamentals. The process for price reporting needs to be simple and transparent and the process for verifying price reporters' compliance with the good faith guidelines should be equally simple.

NGSA members buy and sell billions of cubic feet of natural gas every day and invest billions in the natural gas market for the long term based on confidence in the natural gas market and confidence in the indices. NGSA is committed to ensuring the continuation of indices in which we have confidence.

A few key changes to FERC's price reporting policy and safe harbor could help reduce the regulatory risk and cost associated with price reporting – 1) companies should be permitted to report either monthly <u>or</u> daily transactions without the decision to do so being considered a violation of the safe harbor, 2) the cost of the annual self-audit requirement should be cut in half by changing the annual requirement to an every-other-year requirement, and 3) FERC staff should rely on the company's price reporting audit reports to improve the efficiency and limit duplication of the FERC price reporting audits.

Thank you for the opportunity to participate in the Technical Conference and provide comments.

Respectfully submitted,

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