Revised Posting Requirements for Major Non-Interstate Pipelines Will Increase Gas Market Transparency, FERC Says on Rehearing of Final Rule

At its open meeting held 1/21/10, FERC issued Order No. 720-A (RM08-2) granting a number of requests for rehearing and clarification of Order 720, issued in November 2008, implementing section 23 of the Natural Gas Act (NGA). The Notice of Proposed Rulemaking (NOPR) had been issued on 12/21/07. The final rule prompted numerous challenges.

The latest order revises the regulations requiring major non-interstate pipelines to post daily scheduled volume and other data for certain points on their systems. The changes include a more restricted requirement that major non-interstates post data for receipt and delivery points at which design capacity is unknown. The order also affirmed the requirement that interstate pipelines post data on no-notice service. On the whole, "the modifications that are adopted substantially reduce the number of major non-interstate pipelines that must comply with the proposed transparency regulations," FERC said. Major non-interstate pipelines must comply within 150 days after Order 720-A appears in the *Federal Register*, while interstate pipelines must continue their ongoing compliance.

Background

Staff held a technical conference on 3/18/09 to gather more information on three issues raised in the requests for rehearing of Order 720: (1) the definition of major non-interstate pipelines; (2) what constitutes "scheduling" for a receipt or delivery point; and (3) how the 15,000 MMBtu/d design capacity threshold will be applied. Panelists and participants from the audience represented a "broad cross section" of the U.S. natural gas industry.

On 7/16/09 the Commission requested and received supplemental comments in response to certain issues raised on rehearing and at the tech conference, *e.g.*, how the requirements will apply to receipt and delivery points at virtual or pooling points (with actual gas flow equal to or greater than 15,000 MMBtu/d); and whether to provide an exemption from posting for receipt points where actual gas flows are less than 5,000 MMBtu/d for the prior three years. (FNGR Nos. 2674, pp8-9; 2675, pp5-10; 2688, pp1-2; 2721, pp3-7; 2754, pp3-4; 2761, pp1-6)

Order No. 720-A

Authority for the Rule. The Commission reaffirmed its jurisdiction over the matters addressed in Order 720. Section 23 of the NGA provides limited jurisdiction over major non-interstate pipelines for the purpose of requiring public disclosure of information that enhances market transparency. Some petitioners again challenged the interpretation of "any market participant" under section 23. However, they "have not raised any new arguments," FERC said. "The Commission continues to believe that Congress did not intend to limit the Commission's transparency jurisdiction to entities it traditionally regulates."

Likewise, "no new arguments" were presented on FERC's authority under section 23 to enact rules to achieve interstate price transparency and provide for public disclosure of information. Further, Order 720-A found no merit in arguments based on section 311 of the Natural Gas Policy Act (NGPA). Section 311 limits jurisdiction over some intrastate gas pipeline activities, but NGA section 23 "provides a different jurisdictional basis promoting different Congressional goals." The term "any market participant" includes non-interstate pipelines; thus, FERC can require such participants to post certain data to facilitate market transparency.

Need for the Rule. The Commission observed that some requests for rehearing "appear to argue that the Commission has substantially increased transparency in interstate markets in recent years, but that such transparency is sufficient and more need not be done." This misconstrues section 23 and Congress' transparency goals, declared FERC. As noted in Order 720, "the Commission has been *directed* by Congress to facilitate price transparency in markets for the sale or transportation of physical natural gas in interstate commerce" and authorized to prescribe rules to achieve that goal. As that mandate implicitly

acknowledges, “lack of transparency is not a ‘problem’ readily susceptible to a single regulatory solution. Transparency enhances the ability of market participants to make informed, efficient decisions based upon public information.” In other words, more transparency is typically beneficial to markets, including the wholesale gas market in the U.S., that are already competitive. “It is not a necessary prerequisite to adoption of our regulations to find . . . that the interstate natural gas market cannot function without the rule.” The petitioners themselves acknowledged that the Commission has improved market transparency in several ways in recent years and that the interstate gas market is competitive and robust. “These successes, however, do not preclude other means of further enhancing transparency,” particularly where the Commission has identified a “gap” in relevant market information available to market participants.

Under the new regulations, the understanding of supply and demand fundamentals will be enhanced, FERC continued. Some petitioners, including the Texas Pipeline Association (TPA), argued that data from non-interstate supply pipelines will not enhance interstate market transparency. But Order 720 pointed out that non-interstates have a substantial impact on the establishment of national wholesale gas prices. For example, in the south-central region, they connect large production areas with interstate pipelines. Contrary to the TPA, obtaining data from its members is particularly important for interstate market transparency, FERC said.

Petitioners including the American Gas Association (AGA) also questioned the value of increased transparency at the end of the delivery chain. For example, AGA argued that FERC has not articulated an adequate nexus between data provided by local distribution companies (LDCs), which often deliver primarily to end users, and interstate gas price formation. However, “the Commission disagrees and continues to believe that the pipeline posting regulations will enhance understanding of demand fundamentals.”

Definition of Major Non-Interstate Pipeline. There were two issues on rehearing.

Delivery Threshold. Order 720 had defined “major non-interstate pipeline” as one that (1) is not a “natural gas pipeline” under section 1 of the NGA; and (2) delivers annually more than 50 million MMBtu measured in average deliveries over the past three years. The threshold is consistent with the one adopted for interstate pipelines that file Form No. 2 and eliminates compliance burdens on smaller non-interstate pipelines. In Order 720-A, the Commission held fast to this definition and declined to reconsider various arguments against it.

Treatment of Non-Contiguous Pipeline Systems. Order 720 had also stated that the new threshold will be applied on a “facility-by-facility” basis, which prompted questions about systems that are non-contiguous. On rehearing, FERC clarified that “facility-by-facility” applies to whether a pipeline is a major non-interstate and to whether a major non-interstate is nevertheless exempted from posting requirements. The phrase “was intended by the Commission to indicate that major non-interstate pipelines would be defined by a common-sense grouping of related facilities,” including both physical interconnections and operational integration.

“We believe that this clarification captures the impact that major non-interstate pipelines have on price formation,” FERC said. “If a set of facilities is physically interconnected and operationally integrated, then the facilities, as a whole, impact the natural gas market as one entity rather than as multiple entities.” By “operationally integrated,” the Commission means the facilities transport gas through a centralized scheduling process. “It is at this level of integration that the facilities can be coordinated to such an extent that they may have the effect of a single entity in the natural gas market,” FERC added. “Whether pipelines are organized into separate corporate divisions or formal operating systems is not relevant to this analysis.”

Posting Requirements for Major Non-Interstate Pipelines. The Commission addressed a number of issues raised by various parties including the AGA.

Points Where Design Capacity Is Unknown or Does Not Exist. Many requests for clarification inquired how the new regulations will apply to such points, including (but not limited to) virtual or pooling points,

points not operated by the pipeline, and other physical points for which the pipeline cannot reasonably determine the design capacity.

The Commission granted clarification on this issue. Based on additional information, FERC found that major non-interstate pipelines must post scheduled flow data for points where design capacity is unknown or does not exist only if scheduled maximum volumes are equal to or greater than 15,000 MMBtu on any day within the prior three calendar years. If the largest daily scheduled flow over the past three calendar years equals or exceeds 15,000 MMBtu, then the point is subject to posting. The Commission clarified that, as with posting at points with a known design capacity, posting at points with no known design capacity is required only for *scheduled* volumes. The regulations will not require posting of unscheduled gas volumes or actual flow or posting data for points to which no volumes are scheduled.

<u>Points Where Design Capacity Is Known</u>. Order 720 had found that market participants could use both design capacity and scheduled volume to determine available capacity at a particular point. Therefore, FERC required the posting of both. Where capacity could vary based on operational or usage conditions, major non-interstates must post the capacity for the most common operating conditions during peak periods. Order 720-A affirmed this approach.

"Major non-interstate pipelines must use reasonable efforts to determine design capacity at physical receipt and delivery points," FERC stated. To the extent they are uncertain how to calculate design capacity at physical receipt and delivery points, they can contact the Help Desk for informal guidance. Once again, the Commission declined to adopt a "safe harbor" for calculating design capacity. However, with two minor modifications, it did adopt an exemption from posting for receipt points where actual flows are less than 5,000 MMBtu/d for the prior three years. First, the exemption will apply to receipt points with *scheduled* gas volumes of less than 5,000 MMBtu/d on each day within the prior three *calendar* years. Second, the exemption will apply only to points with a stated design capacity – not to points for which no design capacity is known.

Lastly, the Commission clarified that this exemption does not require that pipelines remove points that have been subject to posting. As in Order 720, "our posting regulations are minimum posting requirements. Major non-interstate pipelines may elect to post additional data regarding their operations."

<u>Timing of Posting of Eligible Points</u>. The Commission had sought additional comment on the appropriate time for posting data from newly eligible receipt and delivery points. One proposal was to require posting for each point within 45 days of its eligibility for posting. Order 720-A granted rehearing on this issue and accepted the proposal. "Such a requirement would allow major non-interstate pipelines to utilize monthly billing and report data to determine the eligibility of new points," FERC said.

<u>Confidentiality and Duplicate Postings</u>. Opponents had argued that posting will competitively disadvantage non-interstate pipelines and their customers. In Order 720, FERC had rejected this argument based on its substantial experience with interstate posting requirements and the aggregated nature of data to be posted by non-interstate pipelines. On rehearing, the AGA suggested that the new rules will conflict with general prohibitions by state public utility commissions (PUCs) regarding disclosure of private customer data.

Most of these concerns were already addressed in Order 720, FERC responded, which "required only posting of aggregated, not account-specific, scheduled flow data." The order noted that interstate pipeline regulations require posting at receipt and delivery points even if the points are customer-specific. FERC added that the industry had benefitted from the transparency afforded by such postings. Congress clearly expressed an intent in NGA section 23 to ensure that relevant market data is made available to the public. Accordingly, Order 720-A rejected requests to limit the posting of information. Moreover, the Commission "does not believe its regulations require the disclosure of potentially sensitive information regarding the physical location of receipt and delivery points or actual natural gas flows that would implicate national security. Our major non-interstate posting requirements do not mandate disclosure of the physical location or composition of receipt and delivery point facilities."

Lastly, the Commission does not believe that the new rules will conflict with state PUC policies. Order 720-A noted that this issue was not raised by the California PUC or by any non-interstate pipelines within the state other than California LDCs. The latter claimed that the new posting requirements “likely” would identify particular customers and usage on their systems, but FERC called these concerns “speculative.”

The AGA also opposed, as duplicative, mandatory posting by major non-interstate pipelines at points of interconnection with interstate pipelines. However, such postings “are not necessarily duplicative, as the Commission's posting requirements for interstate pipelines differ from the requirements for major non-interstate pipelines,” FERC said. Further, “available capacity at points of interconnection may differ between interstate and major non-interstate pipelines and this information would be unavailable if only interstate pipelines posted data. Even if posted information is, on occasion, duplicative, market participants can utilize posted information from one pipeline to better evaluate the accuracy of information posted by the interconnected pipeline. It has been the Commission’s experience administering our interstate posting requirements that ‘duplicative’ postings at interconnections between interstate pipelines are very helpful to market participants.”

Exemptions. Four issues arose with regard to exemptions from the posting requirements.

Pipelines Upstream of Processing Plants. Order 720 adopted an exemption for major non-interstate pipelines that lie entirely upstream of processing, treatment, or dehydration plants. Several companies requested clarification whether the Commission would extend the exemption to major non-interstates that lie entirely upstream of such plants – except for stub lines that are incidental to the operation of the plants.

Order 720-A granted rehearing on this issue. “The Commission is persuaded that a major non-interstate pipeline with a stub line incidental to a processing plant that delivers all of its transported gas directly into a single pipeline should not be required to comply with the posting requirements.” As stated in the Final Rule, gas that requires processing is not fungible with interstate pipeline-quality gas and, therefore, information about the transportation of such gas has substantially less transparency value. On the other hand, FERC added, if a major non-interstate pipeline’s stub line delivers gas to multiple pipelines or to end users, it will not be exempt.

Pipelines that Deliver Primarily to End Users. Order 720 adopted an exemption for major non-interstate pipelines that deliver more than 95% of their volumes to retail customers, as measured by average deliveries over the preceding three calendar years.

The AGA and California LDCs (among others) argued on rehearing that the Commission should extend the retail delivery exemption to major non-interstates based on deliveries to end users – as proposed in the NOPR – rather than retail deliveries. The AGA further argued that other kinds of transactions should also come under the 95% of deliveries included in the exclusion: (1) volumes delivered to and from a liquefied natural gas (LNG) storage facility behind an LDC's city-gate; (2) volumes that flow through delivery points shared with other LDCs; and (3) deliveries from one LDC to another LDC. The California LDCs asked the Commission to require LDCs to post information only at city gates and not within distribution systems themselves.

Order 720-A granted rehearing, given the fact that “deliveries to end users generally have the same effect on deliveries to retail customers (a subset of all end users).” As explained in Order 720, “transparency is enhanced through an understanding of natural gas scheduled flows on non-interstate systems. The structure of natural gas price sales and transportation transactions by an LDC to end users is irrelevant for purposes of interstate price formation.” The Commission further clarified that deliveries to on-system storage facilities, including on-system LNG storage, are included within this exemption. Such deliveries have no effect on interstate price formation.

At the same time, FERC refused to exempt deliveries from one LDC to another LDC, or to require LDCs to post only at city gates and not within distribution systems themselves. “In such circumstances, LDCs are not providing service to end users, but are operating in essentially the same fashion as traditional intrastate pipelines.” The Commission also clarified that major non-interstate pipelines other than LDCs

can qualify for the end user exemption if they meet the delivery threshold. But there is no broad exemption for Hinshaw pipelines that supply end users and other pipelines within a state. "Pipelines that deliver substantial quantities of natural gas to other pipelines for subsequent re-delivery to end-users are not similarly situated with pipelines that deliver 95% of their volumes to end users," FERC said. "Receipts and deliveries at interconnections between pipelines provide useful market information to understand changes in daily flows in response to such things as regional prices; pipeline maintenance; and pipeline disruptions, for example caused by a compressor outage."

Storage Facilities. Order 720 adopted an exemption for major non-interstate pipelines that function as stand-alone storage providers. FERC reasoned that scheduled flow, not gas storage inventory information, furthers the goal of transparency. On rehearing, the Commission refused to extend the exemption to all major non-interstate pipelines that provide storage in addition to transportation service.

Safe Harbor. Order 720 likewise declined to adopt a safe harbor to excuse inadvertent errors by non-interstate pipelines that make a good-faith effort to comply with the posting requirements. FERC differentiated between the posting requirements in this proceeding and the "very limited circumstances" in which it has offered a safe harbor in the past, *e.g.*, the Price Discovery Policy Statement (PL03-3) governing *voluntary* reporting to an index developer. Here, posting is *mandatory* in compliance with the Energy Policy Act (EPAct) of 2005; therefore, there is no policy need to provide an incentive. Other similar mandates, *e.g.*, filing FERC Form 2, generally did not offer safe harbors either.

The Commission acknowledged the temporary safe harbor offered by Order 704-A, with respect Form No. 552 reporting of annual purchases and sales by wholesale buyers and sellers of more than *de minimis* volume of physical gas. But Form 552 will be completed by a large number of relatively unsophisticated companies with little experience filing with the Commission. In contrast, major non-interstate pipelines "tend to be large sophisticated natural gas transportation businesses, often with substantial experience complying with state public service commission reporting requirements, and with dedicated regulatory staff available to ensure compliance with our regulations."

Interstate Pipeline Posting of No-Notice Service. Order 720 required interstate pipelines to post volumes of no-notice service at each receipt and delivery point before 11:30 a.m. central clock time three days after the day of gas flow. Without no-notice information, the market cannot see large and unexpected increases in demand and, therefore, cannot understand price formation both during and after no-notice service is used, FERC said.

The Interstate Natural Gas Association of America (INGAA) called this requirement "arbitrary and capricious." According to INGAA, the Commission should apply to interstate pipelines the same *de minimis* standard for no-notice postings that already apply to major non-interstate pipelines. At the very least, FERC should establish a *de minimis* standard that exempts delivery points with an average annual delivery rate of less than 2,500 Mcf/d.

The Commission was not persuaded – not entirely – "because it believes that all interstate no-notice volumes are relevant to interstate wholesale price formation. Even very small or transitory no-notice volumes can have a substantial impact on natural gas prices during times of system stress. Indeed, it is precisely at these times when no-notice service is most utilized." This conclusion "is reinforced by our authority, exercised in Order No. 637 and elsewhere, to require interstate pipelines to post substantial data regarding their operations," FERC added. However, if a pipeline believes its no-notice service is so insubstantial as to not influence price formation, it may describe its no-notice operations in detail and request a waiver, which the Commission agreed to consider on a case-by-case basis.

INGAA further claimed that, in most cases, there is no way for a pipeline to determine a receipt point for its no-notice service. Therefore, the Commission should clarify that interstate pipelines are not required to post no-notice volumes at receipt points. In addition, INGAA asked FERC to recognize the role of aggregation in administering no-notice service and to clarify that interstate pipelines that report aggregate volume to customers and use aggregate volume to administer no-notice service contracts thereby satisfy the no-notice posting requirement.

Order 720-A acknowledged that there is no way at times for a pipeline to determine a receipt point for its no-notice service. To the extent that the receipt point data is available for no-notice service, however, pipelines must post it. If a pipeline does not have such data, it may indicate that the required data field is left "intentionally blank." The Commission also recognizes that some pipelines traditionally report aggregate no-notice volumes to their customers. But posting aggregate volumes does not satisfy the no-notice posting requirement if a pipeline has access to the record of daily volumes. If the data are available, or could be made available, the pipeline must post the non-aggregated volume data even if it prefers a different format in dealing with customers. If a pipeline lacks access to non-aggregated data, it should post aggregated data.

The Commission assured pipelines that it takes into account that they have varying metering and measurement equipment. Accordingly, Order 720-A clarified that pipelines must only post information that is available to them. "Our transparency regulations do not require the construction of new metering equipment. Instead, an interstate pipeline should post whatever data it has available within three days of the flow, noting any deficiencies in the posting on its website. A pipeline should not post estimated volumes, but rather actual flow. If, subsequent to an initial posting, more complete no-notice service data becomes available, interstate pipelines must update previously posted information."

Additional Exemptions. The Commission granted rehearing and modified the regulations to provide that pipelines with a FERC-approved service area determination may be major non-interstate pipelines if they exceed the delivery threshold and otherwise do not qualify for an exemption. Likewise, LDCs with service area determinations may be major non-interstate pipelines for purposes of this rule. The Commission also granted clarification that a pipeline is an extension of an end user's plant or other gas consumption facilities if it delivers all of its transportation gas directly to an end user that owns or operates the pipeline.

Cost of Compliance. The Commission refused to modify its conclusion in Order 720 "that the benefits of our transparency regulations substantially outweigh the cost of compliance." The TPA and the California LDCs had argued the opposite – that the cost substantially outweighs the benefits. The final rule found that the average annual cost of compliance for interstate pipelines and major non-interstate pipelines was about \$5,000 and \$30,000, respectively. No petitioner objected to the estimate for interstate pipelines, but the TPA and the California LDCs objected on behalf of major non-interstates.

TPA's concerns stem from some "fundamental misunderstandings" of the Final Rule, FERC said. For example, the TPA noted that some of its member pipelines do not schedule flows at certain points, and the rule requires such pipelines to restructure their operations to adopt a scheduling process. But the regulations do not require pipelines to modify their operations so as to schedule gas flows at point where such flows have not heretofore been scheduled, FERC explained. The regulations make clear that major non-interstate pipelines must post the amount of gas scheduled at each relevant point "whenever capacity is scheduled." The TPA also assumes that volumes scheduled to an aggregated receipt point for an LDC customer must be broken out by physical receipt point. As clarified here, the regulations will allow for posting of aggregated scheduled flows to virtual or pooling points.

Finally, the TPA and the California LDCs claimed that the major non-interstates may incur start-up costs of "hundreds of thousands of dollars" to comply with Order 720. However, FERC responded, "such costs seem disproportionately high, given that other major non-interstate pipelines have not expressed similar concerns on rehearing."