GAS TRANSPORTATION AND SALES

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Natural Gas Unbundling

- Occurred over a period of years

- Continues to develop and evolve

- State level unbundling:

  o Many states unbundled, some didn't

  o Some states which began unbundling have retreated

  o A few states, like Ohio, are transitioning to fully unbundled markets

Natural Gas Act of 1938

Established federal regulatory structure for natural gas

Authorized regulation of pipeline facility construction and interstate sale by the Federal Power Commission (or FPC, now known as the Federal Energy Regulatory Commission or FERC)

Created:

- "Just and reasonable" rate authority

- "In the public interest" standard

Phillips Decision (1954)

- U.S. Supreme Court's *Phillips Petroleum Co. v. Wisconsin*, **(347 U.S. 672)**

- Affirmed FPC jurisdiction over:
  - Pipelines
  - Wellhead prices
  - Interstate commerce

Additional Background

- 1940s-1970s: natural gas wellhead price regulated

- Expanded FPC jurisdiction and 1973 OPEC oil embargo of the U.S. created backlog at FPC; natural gas production couldn't be increased sufficiently to meet growing demand
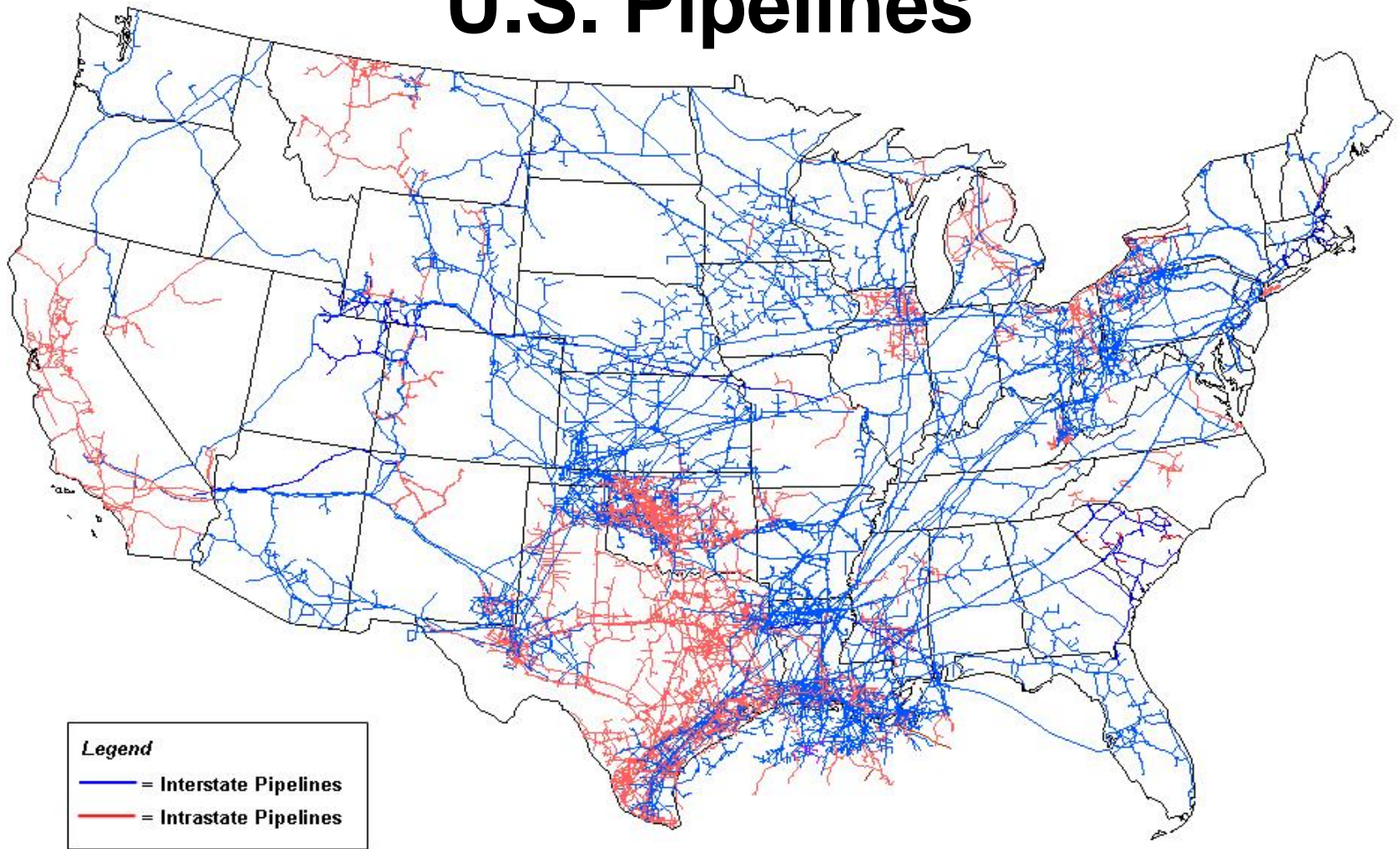
Additional Background

- Mid-1970s: gas curtailment era
  - Significant/sustained and record low temperatures across much of upper Midwest and Northeast U.S.
  - Factories closed
  - Schools closed
  - Significant push to conserve natural gas
  - Prohibition for use of fuel for certain end-uses/processes

Background (continued)

- Late-1970s: long-term contracts required with "take-or-pay" provisions

  - Guaranteed investors & producers payback for investment given low margins at regulated price

  - Required pipeline customers to commit to taking a certain quantity per year or be assessed a penalty

U.S. Pipelines

Legend
— = Interstate Pipelines
— = Intrastate Pipelines

Source: Energy Information Administration, Office of Oil & Gas, Natural Gas Division, Gas Transportation Information System

Background (continued)

- Federal reaction to natural gas supply shortage

  - Natural Gas Policy Act of 1978 – Congress passed law to entice drilling, provided partial price decontrols on new production over existing (vintage wells)

  - Natural Gas Wellhead Decontrol Act of 1989

    - Removed all price controls

    - No FERC authority over wholesale pricing

Natural Gas Policy Act of 1978

Response to curtailment era

Congressional action to entice drilling

Partial price decontrol

"New" production (01/01/1985)

"Vintage" wells

Succession of FERC Orders

- FERC Order 380: 1984; invalidated Take-Or-Pay contracts; eliminated pipeline minimum bills

- FERC Order 436: 1985; response to FERC loss in U.S. Court of Appeals; established non-discriminatory, open-access pipeline structure; direct purchases of natural gas by end users

FERC Order 436

- April 1985
- Response to Appellate Court decision
- Modified Fixed Variable (MFV)
- Non-discriminatory, open-access
- Direct purchases
- Bundled sales

FERC Order 497

- 1988

- Adopted pipeline affiliate rules

- Marketing affiliates

- Insider information

- Info disclosure re: personnel & affiliate transactions

Natural Gas Wellhead Decontrol Act of 1989

- Removed all price controls

- Effective January 1, 1993

- No FERC regulatory authority over wholesale pricing

FERC Order(s) 500, 500A, 500B, etc.

1987, 1988, 1989…

- Addendum(s) to FERC Order 436

- Amended 436 by resolving lingering appellate issues

- Provided mechanisms for settling take-or-pay contract buy-outs

FERC Order 636: The Restructuring Rule

1992

- Mandated unbundling of the sale of natural gas from transportation

- Provided customers with a variety of supplier choices

FERC Order 636: The Restructuring Rule (continued)

- Opened markets to competition

- Changed pipeline rate design to straight-fixed variable rates (SFV rate design)

- Pipelines removed from the merchant function (no longer had the ability to sell natural gas)

FERC Order 636: The Restructuring Rule (continued)

- Downstream pipelines could not retain rights to upstream capacity
  - Right of first refusal (ROFR) given to existing/historical firm capacity holders on downstream pipeline
- Required pipelines to offer:
  - NNFTS (no-notice firm transportation service)
  - FTS (firm transportation service)
  - Open access to pipeline storage capacity
  - Required "capacity release"

FERC Order 637

February 2000

- Enhanced services for balancing/load control
- Scheduling, segmentation, balancing & OFOs
- Revised secondary market price caps
- Permitted seasonal rates
- Provided greater flexibility
- Tightened OFO & penalty parameters
- ROFR

FERC Order 678

June 2006

To facilitate new natural gas storage

Provides for market-based rates

    Where show lack of market power; or

    Where in the public interest & necessary to encourage

    Provides for consumer protections

Other FERC Orders

- FERC Order 670 (January 2006)
  - Prohibition of energy market manipulation
- FERC Order 702 (October 2007)
  - Critical Energy Infrastructure Information
  - RM06-23
- FERC Order 712
  - Promotion of a more efficient capacity release market
  - RM08-1

Recent FERC Initiative

AD12-12: Coordination Between Gas and Electric Markets

- Issues:
  - Interdependency
  - Outages & reliability due to lack of coordination
  - Increasing reliance on natural gas-fired electric generation
  - Role of FERC in oversight
  - Timing of "gas day" versus "electric day"
  - Market harmonization

In Summary

- A journey, not a destination

- Evolution, not revolution

Questions?

Merci!