Electric Cooperative Series: Natural Gas Transactions
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• Counsel numerous electric cooperatives on physical and financial energy trading agreements
• Delivered tailored day+ presentations for cooperatives on ISDA, EEI and NAESB Master Agreements
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2012 Webinar Series: Electric Cooperative Issues

• Webinar I – Top 10 Issues When Negotiating a Power Plant EPC Contract
• Webinar II – Current Issues in Energy Trading Agreements
• Webinar III – Natural Gas Transactions
• Webinar IV – State and Local Tax Issues for Electric Cooperatives
  ▪ Tuesday, November 13, 2012 – 1:00-2:00 p.m. ET
Agenda

• Negotiating transportation and storage service agreements for **existing capacity**
• Entering into **prearranged capacity release agreements** and bidding for released capacity
• How to contract for bona fide **asset management arrangements (AMAs)**
Types of Pipeline and Storage Capacity

• Interstate
  ▪ Regulated by FERC
  ▪ Rates, terms and conditions are approved by FERC
  ▪ Key policies: open access, not unduly discriminatory, transparency

• Section 311
  ▪ Under the Natural Gas Policy Act, intrastate pipelines allowed to provide interstate service
  ▪ Statement of Operating Conditions filed at FERC

• Hinshaw / Intrastate / Gathering
  ▪ Regulated by state commission
  ▪ Some rates, terms and conditions may be negotiated
Contracting for Existing Capacity
Existing Interstate Capacity

• Open and transparent access for awarding capacity
  ▪ Auction process on pipeline “electronic bulletin board”
  ▪ Terms and conditions governed by FERC-approved tariff

• Most flexibility in rates for service
  ▪ Maximum rate
  ▪ Discount rate
    ▪ Non-discriminatory basis to similarly situated shippers
  ▪ Negotiated rate
  ▪ Market-based rate
    ▪ Mostly for independent storage providers
Common Tariff Provisions – Negotiable

• Term
• Rate
• Quantity
• Receipt and Delivery Points
• Injection and Withdrawal Rights
• Flow Rights
Common Tariff Provisions – Not Negotiable

• Title
  ▪ Shipper must have title

• Risk of Loss / Possession / Control
  ▪ Varies depending on pipeline

• Force Majeure
  ▪ Payment of demand charges still required; partial reservation charge crediting immediately or full crediting after period of time (e.g., 10 days)

• Creditworthiness
  ▪ 3 months demand charges

• Billing and Payment
  ▪ Monthly
Common Tariff Provisions – Not Negotiable (cont’d)

- **Capacity Release**
  - Capacity can be temporarily or permanently “assigned” per FERC’s capacity release rules

- **Nominations and Scheduling**
  - Follows NAESB guidelines

- **Curtailment**
  - Interruptible and park and loan services cut first
  - Firm, last to be cut
Permissible “Non-Conforming” Provisions

• Process
  ▪ Pipeline files at FERC for permission as non-conforming
    ▪ Permissible deviation if no risk of undue discrimination
    ▪ Offer to provide to similarly situated shippers
  ▪ Cannot have negotiated terms and conditions of service
    ▪ Exception: If negotiation right is included in pipeline’s tariff; no risk of undue discrimination

• Examples:
  ▪ Early termination rights
  ▪ Credit requirements
  ▪ Limitation on liability
  ▪ Modification by law
Obtaining Released Capacity
FERC’s Capacity Release Program

• **Core Goals**
  - Open access
  - Efficient allocation of capacity
  - Transparency

• In order to facilitate FERC’s capacity release program, FERC created policies designed to create a robust secondary market for capacity
  - Shipper-must-have-title
  - Buy/Sell prohibition
  - Posting and bidding requirement
  - Capacity tying prohibition
Shipper-Must-Have-Title Policy

• Rule: Capacity holder must not ship gas owned by a third party

• Goal: Prevents shippers from providing unregulated transportation services and evading the capacity release program

• “A central requirement of the Commission’s capacity release program is that all shippers must have title to the gas at the time the gas is tendered to the pipeline or storage transporter and while it is being transported or held in storage by the transporter.”
Acting as Agent

- Agency arrangements do not fix a shipper-must-have-title requirement
  - It is possible for a customer to designate a marketer to act as agent to schedule pipeline/storage service and to act as agent to purchase or market natural gas on the customer’s behalf
  - However, such agency arrangements can give rise to shipper-must-have-title and/or buy/sell issues
- Before entering into any new agency arrangements, it is important to confirm that the arrangement will not result in inadvertent violations
Prohibition of Buy/Sells

• Rule: Capacity holder must not enter into an arrangement to buy gas from a counterparty, transport the gas, then resell an equivalent quantity to the same counterparty downstream (or at a later time in the case of storage)

• Goal: Prevents capacity holders from circumventing shipper-must-have-title and capacity release program

• “A prohibited buy-sell transaction is a commercial arrangement where a shipper holding interstate pipeline capacity buys gas at the direction of, on behalf of, or directly from another entity (e.g., an end-user), ships that gas through its interstate pipeline capacity, and then resells an equivalent quantity of gas to the downstream entity at the delivery point.”
New Clarification on Buy/Sells

• Buy/Sell prohibition (and shipper-must-have-title requirement) may apply to interstate transportation and storage services offered by NGA Section 311 and Hinshaw pipelines
  - Section 311 – intrastate pipelines offering interstate service (pursuant to Section 311 of the Natural Gas Policy Act) without being subject to most FERC rules
  - Hinshaw – local interstate pipelines exempt from FERC jurisdiction that can offer regulated interstate service under terms similar to Section 311 pipelines
New Clarification on Buy/Sells (cont’d)

- Arizona Public Service Company and Sequent Energy granted limited waiver for structured buy/sell arrangement and recognized that it has not addressed the issue of whether buy/sell prohibition applies to Section 311 and Hinshaw pipelines.

- FERC issued a Notice of Proposed Rulemaking on this issue in October 2010 and granted a blanket waiver of the buy/sell prohibition for Section 311 and Hinshaw pipelines pending the outcome of its rulemaking, which is still pending.
Optimizing Transportation Assets

• FERC has recognized optimizing transportation capacity as a worthwhile endeavor
• However, buy/sell prohibition applies to spot market transactions (as well as long-term)
• Challenge: Avoiding trading with the same counterparty in a prohibited buy/sell arrangement
• Note: Removal of the maximum rate cap provides opportunity to resell capacity at market value
Optimizing Storage Assets

- The buy/sell prohibition generally applies to storage.
- A prohibited buy/sell arrangement involving storage can result when parties enter into arrangements to trade equivalent quantities over time such that one party is offering something equivalent to storage.
- Consult legal/compliance before entering into any arrangement that might be characterized as the equivalent of offering storage service to third parties.
Capacity Tying Prohibition

• Rule: Capacity holders must not condition releases on extraneous conditions

• Goal: Prevent capacity holders from extracting greater than maximum rate or place unrelated burdens on replacement shippers

• Result: Promotes transparency and allocation to the shipper valuing capacity most
Tying Exemption – Storage Inventory

• Capacity tying permitted for storage releases
• Releasing shipper may require replacement shipper to:
  - Take title to any gas in the released storage capacity at the time the release takes effect and/or
  - Return the storage capacity to the releasing shipper at the end of the release with a specified amount of gas in storage
Posting and Bidding Requirements

• All capacity releases must be posted on pipeline’s electronic bulletin board
• Generally a 3-step process
  ▪ Step 1: Pipeline posts releasing shipper’s offer to release
  ▪ Step 2: Pipeline accepts bids from potential replacement shippers
  ▪ Step 3: Pipeline allocates capacity to the highest bidder (NPV or other specified method)
• Note: Any replacement shipper must meet the pipeline’s creditworthiness standards (prior to bidding)
Prearranged Capacity Release

- Releasing shipper may designate a replacement shipper to receive capacity
- With 4 exceptions, still subject to FERC’s bidding requirements
- Designated replacement shipper will be given opportunity to match the highest bid
Exceptions to Bidding Requirements

• Bidding is **NOT** required if:
  - Release is for a term that is greater than one year (a “long-term” release) at the maximum pipeline rate
    - Note: This is a recent change; previously any maximum rate release (including “short-term”) was not subject to bidding
  - Discounted short-term releases of 31 days or less
  - Releases pursuant to a bona fide asset management arrangement
  - Releases pursuant to a state-regulated retail access program
Limits on Discounted Releases for 31 Days or Less

• No rollovers or extensions
• No back-to-back releases
  ▪ 28-day waiting period
  ▪ Also, watch for “flipping”
    ▪ “Repeated short-term releases of discounted rate capacity to two or more affiliated replacement shippers on an alternating monthly basis in order to avoid the competitive bidding requirement for discounted long-term capacity releases”
Flexibility in Capacity Releases

• Recently, FERC removed rate cap on releases for 1 year or less
  ▪ Capacity can be awarded at market-based rates
  ▪ If replacement shipper pays a rate that is higher than the underlying contract rate paid to the pipeline, the releasing shipper is permitted to retain the excess

• Prearranged releases still allowed

• Can negotiate:
  ▪ Point changes
  ▪ Recall and reput rights
  ▪ Termination rights
  ▪ Tying arrangement permitted if bona fide AMA
  ▪ Can release storage capacity and gas in storage
Recent FERC Enforcement Actions

- ConocoPhillips – $545,000 civil penalty and $3,174,900 disgorgement, plus interest (self-reported)
  - Released capacity to an affiliate at a discounted rate for 31 days or less on an alternating monthly basis under a prearranged deal with the releasing shipper without posting and putting the capacity up for bidding (flipping)
    - Enforcement Staff found that ConocoPhillips earned $322,742 in unjust profits
  - Transported ConocoPhillips gas on pipeline capacity owned by one customer for delivery to third parties and retained title to gas shipped by an affiliate (shipper-must-have-title)
  - Purchased affiliate gas, shipped it on ConocoPhillips capacity, and sold the gas back to the affiliate at the delivery point (buy/sell)
Recent FERC Enforcement Actions (cont’d)

- Atmos Energy and Trans Louisiana Gas Pipeline - $6,364,029 civil penalty and $5,635,971 disgorgement, plus interest
  - Used multiple affiliates to acquire released capacity for 31 days or less at discounted rate in consecutive alternating intervals without posting and bidding (flipping)
  - As asset manager, shipped Atmos gas using other parties’ capacity (shipper-must-have-title)
Negotiating Asset Management Arrangements
Asset Management Arrangements

- Capacity releases with strings attached
- Most basic structure
  - An agreement whereby Party A (the “Asset Manager”) agrees to manage gas supply and delivery arrangements, including transportation and storage capacity, for Party B (typically an end user or supplier that holds pipeline capacity)
  - Party B (the “releasing shipper”) temporarily releases all or a portion of the capacity along with any associated gas production and gas purchase agreements to the Asset Manager
  - The Asset Manager uses that capacity to serve the releasing shipper, and when capacity is not needed to serve releasing shipper, the Asset Manager uses that capacity for other purposes
AMAs (cont’d)

• Three FERC rules created barriers for AMAs
  ▪ Capacity Tying Prohibition: Gas supply obligations could be viewed as prohibited tying arrangements
  ▪ Maximum Rate: Profit-sharing arrangements and discounts on gas supply could be imputed to the rate paid by asset manager, resulting in rates above maximum rate
  ▪ Bidding Requirement: AMAs could be required to be biddable, which would frustrate the parties’ ability to structure AMAs in most efficient manner
The Good News …

- FERC concluded that AMAs are desirable and lead to more efficient allocation and utilization of capacity
- In Order No. 712, FERC granted exemptions to address the barriers to AMAs
  - Capacity Tying Prohibition: Bona fide AMAs are expressly exempted from the tying prohibition
  - Maximum Rate: Fees and profit sharing associated with bona fide AMAs are not applied to the rate paid for purposes of compliance with the maximum rate cap
  - Bidding Requirement: Bona fide AMAs must be posted, but they are exempt from bidding, regardless of the term or rate
What Is a Bona Fide AMA

• To qualify for the exemption, an AMA must be bona fide

  ▪ “Bona fide AMA” is one in which the replacement shipper is obliged to supply natural gas to the releasing shipper or receive natural gas from the releasing shipper (ostensibly using the released capacity)

  ▪ For end-user AMAs, releasing shipper must have call option for gas equal to 100% of the daily contract demand under the capacity release during the lesser of 5 months out of 12 or the term of the release

  ▪ For supply-side AMAs, releasing shipper must have put option for gas equal to 100% of the daily contract demand under the capacity release during the lesser of 5 months out of 12 or the term of the release
What Is a Bona Fide AMA (cont’d)

- If the term is for more than 12 months, any remainder less than 12 months must include a call option of at least 5/12 the remainder.
- If there is more than one piece of capacity, put or call option applies to each segment of the transportation or storage.
- If capacity to be released under the AMA is storage, the Asset Manager’s delivery or purchase obligation need only be up to 100% of the daily contract demand under the release for storage withdrawals or injections, as applicable.
- Releasing shipper can condition its storage capacity release on the sale and/or repurchase of gas in storage.
  - Can specify that a certain amount of gas must be in storage at the end of release.
Posting Requirements for AMAs

- Although exempt from bidding, bona fide AMAs must be posted on pipeline websites
- The postings must identify the release as being pursuant to an AMA and identify the asset manager
- The posting must specify the applicable put/call obligation
Flexibility in AMAs

• Capacity released subject to AMA becomes the Asset Manager’s to use as it chooses, subject to the put/call obligation
• Even when the put/call option is exercised by the releasing shipper, the Asset Manager may supply gas by whatever means it chooses
• The releasing shipper is not required to exercise its put/call option
• Other things to consider:
  ▪ Synchronizing agreements
    ▪ Gas supply and transportation
    ▪ Tolling agreement
  ▪ Recall rights
  ▪ Re-release rights
• Will always want compliance language in AMA
Flexibility in AMAs (cont’d)

• FERC also granted a limited exception to its buy-sell prohibition to enable asset managers to buy from or sell to third parties at the direction of the releasing shipper

• Profit sharing
  ▪ Does not trigger FERC’s capacity release rate cap
    ▪ For example:
      ▪ Paying a fixed optimization fee to the releasing shipper
      ▪ Sharing profits from use of capacity with releasing shipper
      ▪ Making gas sales to releasing shipper at below-market commodity price

• Usage and fuel
  ▪ Pipeline does not have to provide the same discount to the replacement shipper as it gives to the releasing shipper
Questions for the Presenters

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Thank You!

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