FERC Issues Final Rule Revising Capacity Release Regulations

The Federal Energy Regulatory Commission’s (“FERC” or “the Commission”) new rules, which will be effective 30 days after publication of Order No. 712 in the Federal Register, remove the maximum rate cap for short-term capacity releases and exempt from the Commission’s bidding requirements certain capacity release transactions (e.g., releases made pursuant to an Asset Management Arrangement (“AMA”) or state mandated retail unbundling programs).

Except as described below, Order No. 712 maintains the existing framework for capacity releases. For example, the Commission will continue to require that shippers hold title to gas transported using their capacity (“shipper-must-have-title rule”) and generally will continue to prohibit buy/sell arrangements and capacity tying. The Commission’s rules also will continue to require shippers to post capacity releases for bidding on the relevant pipeline’s electronic bulletin board (“EBB”) unless the release falls within one of the Commission’s existing exemptions or one of the new exemptions created by Order No. 712. Regardless of any bidding exemption, all releases must be posted on the pipeline’s EBB along with any special conditions placed on the releases.

1. Removal of Price Cap for Short-Term Capacity Releases

Order No. 712 removes the price ceiling on short-term capacity releases (one year or less). The Commission based its decision on the following findings: (1) market conditions will ensure just and reasonable rates for short-term capacity releases; (2) removal of the rate cap will enable those placing the highest value on capacity to obtain it; and (3) the Commission’s oversight with respect to market manipulation will enable it to monitor the capacity release markets and detect and deter abuses.

Bidding for Prearranged Releases

Because under the new rules, rates for short-term capacity releases will no longer be capped at the maximum Commission-approved pipeline rates, the Commission also is removing the prior exemption from bidding for short-term releases at the maximum rate. Under the new rules, parties still may enter into prearranged short-term capacity releases, but releases for one year or less must be posted for bidding (with the prearranged replacement shipper having an opportunity to match the highest bid) unless the release qualifies for an exemption from bidding available for certain releases that are less than 31 days, or under the AMA or retail marketer exemptions discussed below. The Commission concluded that to allow replacement shippers to avoid the bidding process by paying the maximum applicable tariff rate for a short-term release would undermine the goal of ensuring that capacity is allocated to the shipper that values it the most.

Long-Term Releases and Primary Capacity

The Commission rejected requests that the rate ceiling be removed for long-term capacity releases, explaining that the data does not support removing the cap. The Commission’s goal is to address short-term price spikes, and long-term releases generally are shielded from the impacts of short-term volatility in the market value of the capacity. With regard to extending short-term releases beyond one year, the Commission will consider such extension to be a new capacity release transaction that must be posted for bidding again and awarded to the highest bidder.

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Finally, the Commission also rejected requests that the rate ceiling be removed for short-term sales of primary capacity by pipelines. FERC concluded that pipelines may continue to have market power and should therefore continue to be governed by cost-based rates.

2. **Tying and Bidding Exemptions for AMAs**

Order No. 712 exempts capacity releases made to effectuate AMAs from FERC’s prohibition against tying and capacity release bidding requirements. Generally, capacity holders use asset managers to manage their pipeline capacity and gas supplies by entering into a prearranged capacity release that is tied to their gas supply agreements (both new and existing). FERC’s current capacity tying policy generally prohibits linking a capacity release to any extraneous conditions, such as gas supply requirements. By removing the tying prohibition, FERC’s Final Rule gives market participants greater flexibility to negotiate and implement AMAs, a relatively recent development which makes the capacity release market more efficient. Moreover, to maximize flexibility while limiting the scope of the exemption to “bona fide AMAs,” the Commission defines AMAs to include both end-user and supply-side AMAs and to allow greater flexibility regarding the terms of the AMA.

**Defining AMAs**

The Commission defines AMAs to include arrangements in which the replacement shipper is obligated to deliver to or purchase from the releasing shipper a volume up to the amount released. To provide additional flexibility, the Commission will permit parties to negotiate periods when the releasing shipper will not be entitled to purchase or sell the full amount released so long as the releasing shipper could call upon the replacement shipper to deliver or purchase up to the full amount on any day during a minimum period of 5 months during a 12 month period, or in cases of releases for less than a year, the shorter of 5 months or the term of the release.

Under the new rules, “the releasing shipper will have the right to call upon the asset manager to deliver the full contract volume on every day of the five month minimum, though it need not actually do so.” In other words, the *obligation* to deliver or purchase is sufficient to satisfy the definition even if the releasing shipper never executes its option. Moreover, the asset manager is not required to use the released capacity to transport the gas sold to or purchased by the releasing shipper.

**Exemptions**

The Commission will exempt from its tying prohibition and bidding requirements any release that satisfies its definition of an AMA, regardless of the term and whether the release is subject to the price ceiling. The Commission justified these exemptions based primarily on three factors: (1) AMA releases are distinguishable from traditional releases because the capacity released will be used to benefit the releasing shipper; (2) similarly, AMA releases involve a continuing relationship between the releasing shipper and the replacement shipper and decisions to release capacity pursuant to an AMA involve a

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2 The definition adopted is as follows:

“any pre-arranged release that contains a condition that the releasing shipper may, on any day during a minimum period of five months out of each twelve-month period of the release, call upon the replacement shipper to (i) deliver to the releasing shipper a volume of gas up to one-hundred percent of the daily contract demand of the released transportation capacity or (ii) purchase a volume of gas up to the daily contract demand of the released transportation capacity. If the capacity release is for a period of less than one year, the asset manager’s delivery or purchase obligation described in the previous sentence must apply for the lesser of five months or the term of the release. If the capacity release is a release of storage capacity, the asset manager’s delivery or purchase obligation need only be one-hundred percent of the daily contract demand under the release for storage withdrawals.”
number of factors other than price “including experience in managing capacity and gas sales, experience
with a particular pipeline or area of the country, flexibility, creditworthiness and price;” (3) AMAs promote
the efficient utilization of capacity by allowing sophisticated asset managers to aggregate capacity and
put it to use.

The exemption, however, is limited to releases of an asset management to implement an AMA, and does
not apply to re-releases to third parties during the term of the AMA.

Additional Consideration

With regard to profit sharing arrangements and other consideration exchanged between the asset
manager and the releasing shipper, the Commission will permit a variety of arrangements and provided
the following examples for guidance: “(1) paying a fixed ‘optimization’ fee to the releasing shipper; (2)
sharing with the releasing shipper the asset manager’s profits from the use of the released capacity and
other assigned assets pursuant to an agreed-upon formula; (3) making gas sales to the releasing shipper
at a below-market commodity price; or (4) in some other way mutually agreed upon by the contracting
parties.” In any event, for all long-term releases, the maximum rate cap will continue to apply to the rates
the asset manager pays to the pipeline, but “the price ceiling does not apply to any consideration
provided by an asset manager to the releasing shipper as part of an AMA.”

Buy/Sell Exemptions

Order No. 712 also grants a limited exemption from the Commission’s buy/sell prohibition for AMAs. The
Commission found that releasing shippers should not be required to assign gas supply agreements with
third-parties to their asset managers. The Commission recognized that requiring releasing shippers to
share sensitive proprietary information would strain shippers’ ability to enter into AMAs and could injure
competition. The Commission agreed that the party offering the best asset management services may
not be the party offering the best supply arrangements.

Therefore, the new rules allow releasing shippers to enter into multiple AMAs and employ an asset
manager to transport gas acquired from or sold to a third party. In such cases, to avoid a shipper-must-
have-title violation, the releasing shipper and asset manager will be permitted to enter into a buy/sell
arrangement to allow the asset manager to deliver gas acquired from third parties to the releasing
shipper.

3. Tying and Bidding Exemptions for State Mandated Retail Unbundling

The Commission also found that bundled gas supply and capacity release arrangements by local
distribution companies (“LDCs”) pursuant to state-approved retail access programs should receive the
same exemptions from FERC’s prohibition against tying and capacity release bidding requirements.
Therefore, the Final Rule allows LDCs to release capacity to a marketer participating in a state-regulated
retail access program without posting the release for bidding, and condition the release on the marketer
serving the LDC’s service area.

4. Tying Exemption for Releases of Storage Capacity

Recognizing that the commodity and the storage capacity are “inextricably attached,” the Commission
clarified its prohibition against tying to allow a releasing shipper to condition a release on the sale and/or
repurchase of gas in storage. This clarification stems from the operational challenges associated with
releasing storage capacity, such as injection and withdrawal limits. Under the Final Rule, a releasing
shipper may require the replacement shipper to (1) take title to any gas in the released storage capacity
at the time of the release and/or (2) return the storage capacity to the releasing shipper at the end of the release with a specified amount of gas in storage.

5. LNG Tying Exemption

Finally, the Commission rejected requests for clarification from LNG importers that LNG terminal capacity holders should be able to tie LNG throughput agreements and/or gas sales agreements with a prearranged release of capacity on the pipeline directly connected to the terminal. Although Commissioner Moeller dissented on this point, arguing that the exception is necessary and appropriate, the majority believed that the supply-side AMAs would resolve the issue for importers, and that any necessary waiver of the prohibition could be granted on a case-by-case basis. The Commission indicated that it did not have sufficient information to grant a general waiver.

If you have any questions regarding this alert, or the services we provide, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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