FERC Provides Further Guidance Regarding Revisions to Capacity Release Regulations

Last week, the Federal Energy Regulatory Commission (“FERC”) reaffirmed and clarified Order No. 712, a final rule governing modifications to its regulations regarding the release of firm interstate pipeline capacity. In Order No. 712-A, FERC rejected calls from interstate pipelines to lift the maximum rate cap on short-term pipeline services. On rehearing, FERC said that it continues to find that maintenance of the maximum rate ceilings for short-term pipeline transactions is necessary to protect against the potential exercise of market power. We expect that some parties will appeal FERC’s refusal to lift the rate cap on short-term pipeline services.

FERC also clarified aspects of the final rule that approved the use of asset management arrangements (“AMA”). Although FERC refused to reduce the duration of the delivery or purchase obligation associated with shorter-term AMAs (i.e., less than one year), FERC continued to support the use of AMAs and clarified key aspects in Order No. 712-A. Industry’s increasing reliance on AMAs undoubtedly will result in a more efficient use of pipeline capacity.

Finally, FERC clarified that capacity release transactions that link a release of interstate pipeline capacity to a release of open-access liquefied natural gas (“LNG”) terminal capacity are permissible provided that posting and bidding requirements are met. However, FERC refused to grant an exemption from its capacity tying prohibition to transactions that link a release of interstate pipeline capacity to the use of Natural Gas Act (“NGA”) Section 3 LNG terminal capacity. According to FERC, because Section 3 LNG terminal capacity is not subject to open access policies, any releases or assignments of such terminal capacity would not be transparent. FERC confirmed that it is open to considering waiver requests for such transactions “on a case-by-case basis if presented to it in a fully justified proposal.” (Emphasis added.) However, because the terms governing the use of Section 3 LNG terminal capacity and related supply agreements are commercially sensitive and confidential, it is unlikely that any party will request this type of waiver.

A summary of the key elements of Order No. 712-A are outlined below.

Removal of the Price Ceiling Applicable to Pipeline Capacity

In an effort to reflect changes in the market for short-term transportation services on pipelines, and to improve the efficiency of FERC’s capacity release program, Order No. 712 lifted the maximum rate ceiling on secondary capacity releases of one year or less. In Order No. 712-A FERC again denied requests from interstate pipelines to lift the price ceiling for short-term pipeline services. Previously, FERC explained that pipelines differ from releasing shippers because they are the principal holders of capacity and, therefore, possess a greater ability to exercise market power by withholding capacity and not constructing facilities. FERC reaffirmed this position in Order No. 712-A and concluded that “the removal of the rate ceiling for short-term capacity release transactions is designed to extend to capacity release transactions the pricing flexibility already available to pipelines through negotiated rates without compromising the fundamental protection provided by the availability of recourse rate service.”

FERC also clarified that the lifting of the price cap for short-term releases will apply only to releases that take effect within one year of the date the pipeline is notified of the release. This will prevent releasing shippers from simultaneously posting for bidding consecutive short-term releases at market rates that in
total would extend for more than a year. Here, FERC was concerned that allowing bidding on consecutive short-term releases would result in de facto permission to allow long-term releases at market rates.

Asset Management Arrangements

In Order No. 712, FERC revised its capacity release regulations to facilitate the use of AMAs by allowing parties to link capacity releases to extraneous conditions, such as supply agreements. Moreover, FERC amended Section 284.8 of its regulations to exempt capacity releases executed pursuant to an AMA from competitive bidding. FERC also imposed a delivery and/or purchase obligation on the replacement shipper in order to distinguish between bona fide AMAs that would qualify for the exemptions provided to AMAs and standard capacity releases. FERC’s changes are intended to make the capacity release program more efficient by bringing it in line with developments in today’s secondary gas markets.

No party objected to FERC’s support for AMAs or revisions to its regulations. Primarily, parties requested clarification of the final rule. In Order No. 712-A, FERC clarified that:

- It will retain the current minimum five-month delivery/purchase obligation for AMAs of one year or less. Specifically, FERC rejected requests to implement a 5/12\textsuperscript{th} obligation for short-term AMAs, noting that it established the tying and bidding exemptions for AMAs “as opposed to standard capacity releases on the premise that the capacity released to implement an AMA was not excess capacity of the releasing shipper but capacity that the releasing shipper needed to serve its own needs.” According to FERC, the five-month period is supposed to reflect the releasing shipper’s need to call upon the capacity to serve its own needs during peak periods.
- If an AMA is for more than one year (e.g., 13 months), the five-month delivery/purchase obligation would apply to the first 12 months and the 5/12\textsuperscript{th} rule would apply to any additional period of the release not equal to 12 months (e.g., to the 13\textsuperscript{th} month).
- The delivery/purchase obligation for an AMA need not be for a single, consecutive period. Thus, the minimum delivery/purchase obligation “may be satisfied by use of any combination of months and/or days during the term of release that equals the requisite obligation for that release.”
- With regard to the delivery/purchase obligation included in an AMA that includes a release of storage capacity, the maximum delivery/purchase requirement must be consistent with the limitations related to injection and withdrawal rights in the service provider’s tariff.
- Where the AMA includes both upstream and downstream pipeline capacity, the delivery/purchase obligation must apply to the full contract demand under each capacity release in the transportation chain.
- AMAs and retail unbundling releases are exempt from the prohibition on rollovers and extensions of a 31 days or less release to the same replacement shipper without bidding. FERC confirmed that the goal of Order No. 712 was to “facilitate AMAs and state unbundling programs that would give retail end-users a greater choice of suppliers by generally exempting certain releases from its bidding requirements.”
- Outside the context of an AMA or retail unbundling release, in order to qualify for the maximum rate exemption from bidding, the release must be for a term of more than one year.
- Posting the specifics of the delivery/purchase obligation is required in order for the Commission to determine that the AMA is bona fide.
- FERC, in Order No. 712, did not intend to amend its regulations pertaining to the Index of Customers. However, the Commission noted that under the existing regulations, a pipeline’s transactional report will indicate whether the releasing shipper and the asset manager are affiliated.
- The posting requirements for capacity release associated with AMAs apply to those releases that took effect after the effective date of Order No. 712.
Parties to an AMA may specify a deadline (no earlier than 8:00 a.m. on the weekday before gas flows) after which the asset manager may re-release the capacity without attaching a recall provision. This is consistent with FERC’s goal of maximizing the value of capacity pursuant to an AMA.

Capacity included in an AMA is not limited to the capacity that the releasing shipper historically used to meet its needs. Such excess capacity also will be subject to the delivery/purchase obligation.

An asset manager may release capacity it obtained as part of an AMA to another asset manager. If the release is made to implement an AMA and meets the delivery/purchase obligation, such release would qualify for the tying and bidding exemptions granted to AMAs.

Any type of party can enter into an AMA, so long as the relevant criteria is met.

With regard to state-mandated retail unbundling, the Commission agreed that consecutive, short-term releases to a marketer participating in a state-regulated retail access program would not be considered a long-term release subject to the maximum rate ceiling. FERC reasoned that marketers in this case have no continuing right to capacity from one release to the next because rights to released capacity depend on the marketer’s continued participation in the state program. Moreover, FERC confirmed that a marketer participating in a state program can re-release its capacity to an asset manager that will fulfill its obligations. Also, if the asset manager is not using the capacity to supply retail access customers, it can use that capacity for other purposes. However, FERC refused to grant an exemption from tying and bidding to wholesale marketers that receive capacity directly from an LDC as part of an unbundling program but is not a marketer in the state program or to those participating in a program that is part of a self-regulated municipality.

Tying Storage Capacity and Inventory

Order No. 712 confirmed that parties can release storage capacity and related inventory together without running afoul of FERC’s prohibition on capacity tying. In Order No. 712-A, FERC clarified that parties may negotiate further terms and conditions related to the commodity portion of the transactions and that such agreements will not be subject to FERC’s prohibition against tying capacity releases to extraneous conditions. For example, parties can agree to defer payment for the commodity in storage or involve in-kind payment. Finally, FERC confirmed that when storage capacity is posted for bidding, and the release also includes gas in storage, the capacity will be awarded to the party that submits the highest bid for the storage capacity only.

LNG

In Order No. 712, FERC rejected requests that parties be allowed to link LNG throughput agreements and/or sales of gas at the outlet of an LNG terminal with a prearranged capacity release on an interstate pipeline connected to the terminal. In Order No. 712-A, FERC clarified that with respect to LNG terminals providing open access service, where both the LNG terminal and the directly connected interstate pipeline are subject to Part 284 open access regulations, existing policy allows a holder of capacity in the LNG terminal to tie its connecting downstream pipeline with terminal capacity. However, FERC clarified that if such release is between 31 days and one year, it must be posted for bidding.

FERC declined to revise the final rule to apply to capacity at non-open access LNG terminals (NGA Section 3 facilities), finding that the agency lacks knowledge on how such arrangements would be structured and, therefore, that it lacks a process to “ensure that a release of terminal capacity would be non-discriminatory and transparent.” Although FERC declined to grant a blanket exemption from tying and bidding in the context of a non-open access LNG terminal, the agency reiterated its point in Order
No. 712 that it is open to considering waiver requests for such transactions on a case-by-case basis provided such request is made in a fully justified proposal.

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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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