Title: Federal Energy Regulatory Commission (FERC) by Loy Upp

FEDERAL ENERGY REGULATORY COMMISSION (FERC)

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Introduction

May 18, 1992, a set of Federal Energy Regulatory Commission (commonly referred to as, FERC) orders became effective and established a new philosophy on how natural gas will be sold, transported and stored. This is a continuation of FERC orders designed to deregulate the market for natural gas. This effects all aspects of the industry; production, transmission, storage and distribution. The actual effects on each are still being developed with new rulings, filings and law suits to insure a full open access networked pipeline industry results.

Sense of the 636 Ruling

When FERC decided that the customers would be better served (i.e., lower prices) by going to the open access type of pipeline operation in 1985 (order 485) and 1987 (order 500), a problem arose on the proper pricing for gas that was not "bundled" by previous contract requirements. "Bundle" means pipeline transportation, storage and sales were put together in one package by the pipelines to the local distributor. These resulted in inequities of pricing and the priorities at purchase and sales points under "bundled" contracts. This led FERC to eliminate these restrictions which had made true "open access" operation impossible. At this time, the pipelines that the order applies to are approximately 75 "Jurisdictional" pipelines. Rule 636 addressed these concerns so that pipeline customers could rely on non-pipeline suppliers for peak and base supplies. This makes the pipeline less in control of gas prices. This, then is the purpose of 636 in general, however, the more difficult part is how to implement this goal in detail. But, it should mean capacity rights, gas prices of pipeline or its producing affiliate, gas bought by a distribution company or end user and transported by a pipeline, storage gas, and different services will be in a more competitive market. Basically, pipelines should become transporters, and producers should have free access to all pipelines and markets, and gas is marketed as a commodity.

Provisions of 636

The details of the requirements could take hours to cover, but of more importance is what does the order 636 for pipelines mean to producers, pipelines and distribution companies. The effects will vary since each pipeline who must respond to the rule has filed its own plans to implement 636 with details left to the contractual parties to work out. Almost daily changes are being made based on new FERC rulings and interpretations. Listed below are some of the areas of concern that are still developing.

Pipeline Restructuring

All pipelines were required to submit new tariffs to restructure by the end of 1992 to completely unbundle their services and to make changes in their operations necessary to accomplish this. This means that pipelines are required to offer firm and interruptible services that are equal whether the gas is purchased or sold from the pipeline or any other producer or seller. These services require flexibility in receipt and delivery points, storage, scheduling and balancing rights that require continual monitoring of flows in and out of the pipeline.

Cost of Restructuring Pinelines

Estimated costs to meet the 636 requirements by various pipelines vary widely from pipeline to pipeline. A major pipeline has estimated their cost at $559 million and had this approved by FERC. Several smaller pipelines estimates their cost at zero. The total estimated cost of the 13 tariffs approved to date total 1.3 billion. Other pipelines fall between these extremes, with some 62 pipelines yet to hear from their filings. However, it appears that the original cost estimate of 8 billion is too high. FERC has approved cost recovery mechanisms, but has not addressed claims for actual recovery of transition costs. Basically, these transition costs will be recovered through rate increases to the customers.

Market Based Sales Rates

Sales rates for these flexible services will be set by the competitive market place and does not require FERC approval. Rates are one of the most controversial points raised by 636 and are an important concern, but will not be covered further, because of their complexity. However, one guiding principle has been established: "pipelines will not lose money on these changes, which will be borne by the customers." An important part of a pipeline costs will be their ability to operate efficiently with the new regulatory requirements and this requires close pipeline control which with flexible service makes it difficult to accomplish. Knowledge of these influences on rates will help producers and distribution companies understand the pipeline's problems.

Shipper Capacities

Shippers with firm transportation rights may release this capacity to replacement shippers without restrictions based on an undefined bidding process. This makes possible rapid changes in metering inputs in the purchase areas and sales points in the distribution areast providing accessibility is available through multiple sales point and interchange options.

No Notice Service

Pipelines must offer the right to receive nominated pipeline capacity to meet unexpected requirements. Pipelines will establish operational conditions to maintain their operational requirements, but should be able to accommodate these needs. Once again, timely knowledge of flows and capacities is required.

Access to a Pipeline's Upstream Capacity

All pipeline firm transportation capacity shall be made available to customers without considering "ties" between upstream capacity and the supply contract.

This requirement gives all parties equal access to a pipelines available capacity.

Electronic Bulletin Boards

Electronic Bulletin Boards (EBB) are required so that all producers and distributors will post and have current pipeline transportation information such as capacity releases which can then be sold to the highest bidder. All of these changes listed above for pipeline operators effect contracts, rates, operational requirements, costs and communication requirements for suppliers. The detail requirements of these developments are of prime importance to follow for all operators in the gas industry. A major problem of the ruling is one of having a target date to meet the 636 requirements by the 1993-94 heating season which is less than a year away.

Gas Measurement Effects

To look further into the effects that are anticipated in the area of gas measurement, there will be a heavy increase in need to know flows in real time. However, the details of this requirement are in question since the order contains no uniform standard as to what constitutes an Electronic Bulletin Board. At present, every pipeline has a variable amount of timely information available, but in their own formats. To make the system workable, accurate information on flow volumes and available pipeline capacity needs to be standardized one suggestion is to have current receipts and deliveries available at the EBB in a common form for the pipeline and the other parties to their contracts (i.e. producers and distributors). This would minimize imbalances, provide available capacity information, contract quantity control data and make an open access operation more likely.

Penalties

Imbalances in contract deliveries are addressed in requiring pipelines to maintain operational control and allowing "appropriate penalties" to encourage proper scheduling. The magnitude and disposition of the penalties are not specified and the method of resolving imbalances are not set. However, it is this aspect of the order that is encouraging the application of electronic flow meters on purchases and sales and the more extensive use of interchange and check meters. With these, the pipeline throughput is available in real time to both producers and customers who can adjust their volumes accordingly.

The types of penalties for delivery inadequacies are not set by 636, but are left to the pipelines, producers and purchasers to work out. Types of possible settlement of volume disparities from nominations that might be used are "Cash Out" which pays the shipper for "excess delivery" at a discounted price, or the shipper must purchase the "short delivery" from the pipeline at above the market price. This makes the delivery of the correct volume financially profitable for all parties. Another method of settlement is "Book out" which allows shippers to use other shippers over or under deliveries to meet their requirements. If there is a disparity in the rates of the two shippers, then the pipeline would absorb this difference which could result in a gain or loss. Once again, timely and correct volumes are required.

Real Time Metering

It becomes evident that real time flow volumes for control of 636 requirements will be needed at least at all large purchase and sales stations. How far down this comes in terms of smaller stations depends on how significant the volumes are in affecting a pipelines operating control. Some statements have been made that all purchases and deliveries will need computer volumes. This will probably be a matter of economics and is more likely not going to be an immediate happening. However, there are a number of producers, pipelines and distribution companies asking for quotations on quantities of electronic flow computers in anticipation of the implementation of 636.

Market Centers

Market centers have been established in key production areas, such as Erath, Louisiana, Blanco, New Mexico, Midland/Waka, Texas where smaller producers combine to effectively interface with pipelines, market brokers, and gas purchasing pools. Some of these are in full development with meter stations and electronic equipment being installed and operation begun to establish information for the EBB of the participants. They give flexibility to react to changing market needs. An example of one hub is the one located in Katy, Texas outside of Houston. It is unique in that there are nine pipelines with two storage areas that are set up for interchanges. The Hub offers programs for transportation and exchange, imbalance control, market information and custom sales. Similar hubs are being developed in the large distribution areas such as Leidy, Pennsylvania and Lebanon, Ohio and Tuscola, Ill.

Comments from Producers

The following is a summary of some of the comments that have been made by producers regarding the 636 rule:

1. It appears that the producer who holds a firm transportation agreement will be penalized, however pipelines will need the firm agreements.

2. Each pipeline negotiation is different, but the same question arises, "How to split and cover the transition costs?"

3. A uniform electronic bulletin board is a must.

4. The independefit producer must be prepared to offer complete market services beyond just selling the gas.

5. The pipelines must not view this as a chance to "rape" producers with extra service charges and recovery of costs.

6. End users should look to producers versus marketing companies to insure gas deliveries.

7. The producers must install a gas management program to deal with nominations, imbalances, storage and other areas affected by the restructuring to be more efficient in the movement of their gas.

8. It remains to be seen if producers are better or worse of with Rule 636 and this depends on unbundling being handled without bias.

9. Unbundling should include pipeline owned gathering lines which could then serve multiple pipelines.

10. Producers will be required to review the viability of their supplies and possibly aggregate some supplies to maximize load factor and minimize demand charges.

Comments by Pipelines

1. Minimal incentive to develop new markets.

2. Will depart from the merchant function. Present contracts storage capacity and pipeline capacity will be made available to current sales customers. Merchant function will be transferred to an affiliate. Will be required to implement a more advanced capacity release capability.

3. Need more focus on who will do market development for the gas industry.

4. Not particularly happy with other pipeline proposals.

5. We will not be better off under the rules in that we will lose flexibility and ability to provide incremental services (second tier pipelines) . Long lines should be better off. (636 not directed to second tier pipelines.)

6. FERC is heading in the right direction, but needs more attention to unbundling and rebundling procedures and opportunities.

7. Gas acquisition staff shifting to affiliated distribution company. Additional real time measurement equipment may be required.

8. Need to increase staff (maybe temporarily), need to develop new products and services, need to get "real time" on systems.

9. Seriously evaluate providing the merchant function under the auspices of an affiliate - evaluate the supply group.

10. Work to standardize Electronic Bulletin Board

11. Make sure the gas continues flowing, service is efficiently provided and costs are recovered.

12. Get "real time" systems and get "lean and mean".

13. Accept the inevitable and negotiate in good faith towards compliance.

14. Be flexible in operation areas.

15. Stream line procedures, enhance value of capacity and make it marketable in comparison to other pipelines. Discount interruptible services to make it competitive with firm.

End Users should:

1. Look to producers (vs.) marketing companies for their gas needs to make sure

the gas will be there day to day.

2. Review their options regarding gas procurement/transportation.

3. Orient its gas supply function to focus on swing capability and security of supply, as appropriate, and make sure backup systems are kept functional.

4. Make sure they understand how to arrange for their gas to move on the pipes and distribution systems and that they have a secure source of gas or else pay someone reliable to do it for them.

5. Be prepared for a lot of headaches as they will now be forced to do a lot more for the same service but, hopefully, will realize cheaper costs overall.

6. Evaluate a supplier's ability to perform in the new environment recognizing that a penny or two savings on gas cost at the beginning of the month may not be there when all is said and done.

7. Long term strategy for serving themselves.

8. Establish supply alternatives to the interstates. Focus activity at a few hubs strategic to their location.

9. Determine whether, in the long run (and short run) , it is better to hold firm capacity or to purchase from suppliers/marketers that hold capacity. This may depend on the likelihood that capacity will be scarce.

Local Distribution Companies

1. Look to producers for the security they provide in the supply base.

2. Who is to cover transition cost?

3. Coordinate their services with interstate pipelines to ensure that certain end users do not have a competitive advantage.

4. Same as ended users but with more emphasis on security of supply and swing capability.

5. Make sure their suppliers do a good job; be prepared to release unused pipeline space for the most money; and make sure your state commissions are on board with your plans.

6. Be prepared for increasing staff and lots of headaches to manage their gas portfolios in the future with potentially increasing state PUC oversight.

7. Carefully plan purchases and services.

8. Consider whether they can reduce their reservation charge burden by relinquishing capacity; switch to seasonal contract quantities to improve load factors; maximize opportunities to release capacity.

Marketers

1. Carve out distinct niche areas they can work effectively.

2. Evaluate the new opportunities and niche rolls that can be filled; i.e., fuel managers.

3. Meet with end users, pipelines, and local distribution companies to determine market need for marketers.

4. Determine how is will address the supply security issue.

5. Understand how to move gas on the pipelines. Understand what their customers need. Help, don't hinder, the process by not paying attention.

6. Either find niches of customer service or merge into big entities for economics of scale.

7. Have assets behind them.

8. Develop new services to replace pipeline services and to work in conjunction with the pipeline (supply for no notice services, etc.).

9. Look for ways to align themselves with local distribution companies or producers (multiple options are available).

10. Hard wire in some real supply. Strategic alliance with producers. Don't offer producers a net back "black box".

11. Pool supplies; aggregate customers; make best use of primary, second market centers; make use of flexible delivery and receipt points; use mix of firm and interruptible (discounted) transport: key will be to maximize use of any firm capacity held; mix of long term or short term contracts.

Consultants

1. Understand the order thoroughly and be able to provide direction to small players who cannot afford full-time staff.

2. Focus on LDC's and what services it can provide as the LDC moves into the order 636 world, particularly how is can be defended in front of its state commission.

3. Look for producers and LDC's that need their expertise.

4. Bring real value to clients not just promises.

5. Talk to lawyers!

Financial Service Companies

1. Prepare to either absorb a lot more risk or have someone else take the risk.

2. Understand the impact that Order 636 will have on company incomes that may be a potential user of financial service companies.

3. Continue as before.

4. Understand what the new world will look like, select those people they believe will survive, style financing that will service those survivors.

5. Be very concerned about the assignees of firm capacity and their ability to pay reservation charges.

Summary

It appears certain that the meaning of rule 636 to each of us is not clear. Because of continual ruling on pipeline filings and the controversial nature of them (over 50 law suits have been initiated) it is going to be very difficult to resolve the issues by the end of 1993. Added to this the new Clinton administration will fill three commission seats and numerous staff positions so there may be some new directions added to the confusion. In addition, new concepts of real time measurement, market centers and data presentation, add new considerations in answering the requirements. At this point in time, it is important to keep up with rulings and the plans of the pipelines with which you interface, recognizing that each pipeline will have its own unique interpretations of Rule 636.

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