ProComply Regulatory Advisory

Promotion of a More Efficient Capacity Release Market:

Federal Energy Regulatory Commission Order No. 712

The Federal Energy Regulatory Commission (FERC) has again revised the capacity release rules for shippers on interstate pipelines regulated by FERC. On June 19, 2008, FERC issued Order 712 which will become effective on July 30, 2008. The Order revises Part 284 of their regulations and provides, in part:

- Elimination of the price caps on transactions of one year or less.
- Allowing the use of Asset Management Arrangements (also called Asset Management Agreements, or AMAs) as a mechanism that exempts shippers from bidding requirements, buy/sell prohibitions and tying arrangements.
- Specifying that consideration provided to an asset manager does not apply to the price cap.
- Removing the prohibition on transactions involving gas in storage and releases of firm transportation. This applies to both typical capacity release transactions and ones that are part of an AMA.
- Eliminating the prohibition on tying and the bidding requirements for releases made pursuant to an approved state retail access program.
- Exempting standard capacity releases made under state-approved retail access programs from the prohibition on tying and from the bidding requirements.

I. Eliminating Price Caps on Transactions of One Year or Less

In Order 712, FERC eliminates the rate cap on capacity release transactions of *one year or less*. FERC believes that the pipeline's cost-based max rates will check the exercise of market power by the 'releasing shippers' (i.e., either by charging rates above the price ceiling or by withholding capacity) because pipelines are obligated to sell any unused capacity as interruptible service to shippers at no more than the max rate. FERC leaves intact the price cap for long-term capacity release transactions and for short-term primary sales of capacity by pipelines.

II. Asset Management Arrangements

FERC amended its rules in several ways to smooth the progress of the use of AMAs. AMAs are typically structured as follows: a shipper holding firm transportation and/or storage capacity temporarily releases all or a portion of its capacity along with associated gas production and gas purchase agreements to an asset manager (here, the replacement shipper), which uses the released capacity to serve the gas supply requirements of the releasing shipper.

A. Exemption from Bidding Requirements and From Prohibitions on Tying and on Buy/Sell Transactions

Bidding. In Order 712, FERC exempts all pre-arranged releases to implement AMAs from the bidding requirements of Section 284.8 of the regulations. This exemption applies *regardless of the term of the AMA* and whether the release is otherwise subject to the price ceiling applicable to long-term capacity releases. Capacity releases under short-term AMAs may be rolled over without the need to bid.

Tying. FERC also exempts such capacity release transactions from the prohibitions on tying and buy/sell transactions. The tying exemption permits a releasing shipper in a pre-arranged capacity release to condition the release on the replacement shipper:

(1) Agreeing to supply the releasing shipper's gas requirements and/or

(2) Taking assignment of the releasing shipper's gas supply contracts.

<u>The tying exemption does not apply to re-releases by the replacement shipper to third parties.</u>

Buy/Sells. The buy/sell exemption permits the releasing shipper to negotiate its own gas purchase arrangements with a third party, sell the gas to the asset manager to transport over the released capacity, and then resell that gas back to the releasing shipper at a downstream delivery point.

B. Definition of Qualifying AMAs

FERC defines AMAs that qualify for the above exemptions as: 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.

This definition distinguishes AMAs from standard capacity releases by placing a significant delivery obligation on the asset manager, applicable during at least five months out of each twelve-month period of the release (or, for short-term capacity releases, the lesser of five months or the term of the transaction). The asset manager may utilize the capacity for its own purposes (e.g., for re-releases or to make third-party sales) during the remaining period. This definition also permits parties to enter into gas supply AMAs (i.e., an arrangement in which a production area capacity holder releases capacity to an asset manager that commits to purchase the releasing shipper's gas and use the released capacity to transport and market such gas on behalf of the releasing shipper).

C. AMA Profit-Sharing Arrangements

Currently, AMA profit-sharing arrangements may violate the price ceiling if the capacity is released to the asset manager at the maximum rate and the asset manager shares with the releasing shipper profits from its use of the capacity (e.g., from re-releases or third-party sales). FERC modifies Section 284.8(b) to permit such profit-sharing arrangements by clarifying that the *price ceiling does not apply to any consideration provided by an asset manager to the releasing shipper as part of an AMA*.

D. Posting and Reporting Requirements

Despite the AMA exemptions described above, releases under AMAs nevertheless remain subject to the existing posting and reporting requirements. In addition, *FERC adds new reporting requirements* which require postings as to:

(1) Whether any capacity release is to an asset manager, and

(2) If so, the delivery or purchase obligation in the AMA, which must specify the volumetric level of the replacement shipper's delivery or purchase obligation and the time periods during which that obligation is in effect.

FERC also clarifies that the "special terms and conditions" reporting provision *does not include* commercially sensitive details of an AMA, such as information concerning the gas commodity aspects of the AMA and compensation.

IV. Tying Storage Capacity and Inventory

FERC modifies its prohibition on tying to allow all releasing shippers to condition releases of firm storage capacity on a requirement that the replacement shipper:

(1) Take title to any gas in the released storage capacity at the time the release takes effect 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.

V. State Mandated Retail Unbundling

FERC also extends the tying and bidding exemptions to releases by a local distribution company ("LDC") to a marketer that agrees to sell gas to the LDC's retail customers under a state-approved retail access program.

These exemptions apply regardless of the rate at which the LDC releases its capacity to the participating marketers, but does not apply to re-releases made by the participating marketers.

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