Commissioner Philip D. Moeller's Inquiry into the Trading of Natural Gas and the Proposal to Establish an Electronic Information and Trading Platform

Docket No. AD14-19-000

COMMENTS OF THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

On September 18, 2014, Commissioner Moeller convened a meeting to consider a national electronic information and trading platform for natural gas. In response to the commissioner's invitation to submit additional comments, the Interstate Natural Gas Association of America (INGAA) offers several observations regarding the topics discussed at that meeting. In order to remain within the prescribed page limit for written comments, INGAA's comments below will be summary in nature.

1. Hourly nominations should not be confused with non-ratable flow rights.

A number of meeting participants suggested that gas pipelines offer a service providing shippers with the opportunity for non-ratable takes in order to meet the needs of power generators. Other speakers noted that some pipelines currently provide shippers with the opportunity to make hourly nominations for pipeline transportation and, assuming that capacity is available, commence flows within the hour. They suggested that all pipelines permit hourly nominations. These two aspects of natural gas pipeline transportation service are distinctly different and should not be thought of as interchangeable concepts. Nominations on an hourly basis allow shippers to nominate and start flowing gas between the standardized North American Energy Standards Board (NAESB) nomination cycles. These additional opportunities to nominate do not authorize a shipper to take gas non-ratably if not otherwise permitted by the tariff (i.e., a shipper is not otherwise permitted to take gas faster or slower than $1/24^{th}$ of the scheduled capacity per hour over 24 hours).

When operationally possible, all pipelines permit shippers to take gas non-ratably on a "best efforts" basis. Whether a pipeline can accommodate non-ratable flows depends on how other shippers are using their entitlement to pipeline capacity and the operational flexibility of the pipeline (e.g., line pack, storage availability, whether other shippers are using the system ratably, how planned maintenance affects capacity). For a pipeline to offer non-ratable flow on a firm basis, however, a shipper must sign up for a firm transportation service that has been designed to provide non-ratable takes. In many cases, this may include the shipper paying the incremental cost of expanding the pipeline to support the maximum volume that could be scheduled under the terms of its contract with the pipeline. Pipelines are not designed to provide interruptible shippers with this capability on a firm, guaranteed basis.

2. There are reasons to doubt that pipeline nomination, confirmation, and scheduling can be automated fully so as to guarantee that the process can be completed in near real-time.

Several meeting participants noted that some pipelines provide shippers with the opportunity to make nominations and flow gas beyond those identified in NAESB standards and incorporated by reference into Federal Energy Regulatory Commission regulations. While true, a pipeline's ability to offer "out of cycle" nomination opportunities should not be interpreted as proof that the

entire pipeline nomination, confirmation and scheduling process, in particular the Timely cycle, can be automated fully in order to shorten significantly the time for this process. The effort to implement the initial allocations in the Timely cycle, where the vast majority of nominations occur, remains time consuming and resource intensive, and must be performed carefully to ensure reliability.

The pipelines that offer additional intra-day nomination opportunities in their tariffs have made significant investments in pipeline infrastructure, information technology, communications systems and staff necessary to permit this to occur. Still, even on those pipelines that offer the additional "out of cycle" opportunities, the number of nominations that occur within the additional windows remains substantially less than the number of nominations in the Timely cycle. This, coupled with the fact that most capacity is allocated during the Timely cycle, greatly simplifies the task for the pipeline in determining whether it can schedule "out of cycle" nominations and begin flowing gas within a short period of time.

The framework for achieving the Commission's goal of non-discriminatory open access transportation is predicated on an allocation of the majority of pipeline capacity in the Timely cycle that includes consideration of both shippers' entitlements to capacity (e.g., segmentation, flexible receipt and delivery points, secondary point rights, capacity release rights) and how to operate the pipeline most efficiently and reliably. It has not been demonstrated that capacity allocation can be accomplished purely by applying an algorithm without the expertise and oversight of the pipeline operating staff.[1] In addition, a fully automated process would limit the ability of a pipeline to resolve customer nomination errors, which today are resolved by person-to-person communication; a fully automated system would reject a customer's incorrect nomination and gas would not flow.

During the Timely cycle, for example, firm shippers with primary point capacity may nominate gas to a secondary point either by the firm shipper or a shipper that has obtained the capacity through a capacity release transaction. The pipeline operator must evaluate the physical capability of the pipeline to move gas to this secondary point. As part of this analysis, the pipeline operator must consider a variety of variables, such as how customers historically have used their contracts to determine whether it is likely that a no-notice customer will require increased deliveries, up to its maximum contract quantity, later on and whether the pipeline must be re-packed because line pack had been depleted by the need to respond to a recent cold spell or other high demand event. Once the pipeline schedules the secondary service nomination, under Commission policy, it is considered firm and must be served as if it involved primary receipt and delivery points. Accordingly, this allocation must be done carefully to ensure reliable pipeline service.

If pipelines are asked to provide seamless confirmation of flow through multiple interconnected pipelines, the complexity of this allocation process would be exponentially more challenging. Moreover, it is doubtful that an interconnected pipeline without storage could balance seamless flow instantaneously across pipelines.

[1] An added complication would be interconnections with non-jurisdictional entities, including intrastate pipelines, etc. and at international borders.

3. Pipelines can offer customized services that are designed to meet the needs of firm shippers.

Some meeting participants suggested that pipelines offer near, real-time transportation service. Pipelines can and do develop services to meet the needs of firm shippers. Accomplishing this, however, requires the pipeline to allocate and dedicate facilities to assure that the service is reliably available. If there is unsubscribed capacity, the pipeline can use those facilities to offer a customized service so long as it is offered on a non-discriminatory basis. In constrained markets, however, the pipeline must construct new facilities, which requires the long-term commitment of firm shippers.

Many pipelines offer no-notice service, which allows a shipper to nominate outside the standardized NAESB cycles and start taking gas with little or no notice. Pipeline infrastructure (including storage facilities) has been dedicated to support a pipeline's ability to deliver gas at a moment's notice. The service is predicated on the availability of both reserved pipeline and storage capacity to support the pipeline's ability to deliver, on a ratable basis, the maximum contract quantity at any time, without requiring the no-notice shipper to submit an advance nomination during the Timely cycle. For this reason, pipelines without storage, or access to storage, typically cannot offer no-notice service. The service also is predicated on the shipper's willingness to pay the cost associated with the capacity allocated to the service. Given these realities, it likely would be cost prohibitive for a pipeline to offer a universal no-notice service to all shippers on its system (if it even could offer no-notice service). Moreover, many of the firm shippers on the pipeline likely would object to incurring the additional costs of purchasing a no-notice service.

Some pipelines offer non-ratable flow services on a firm basis. These services are contingent on sufficient pipeline capacity, compression, and often storage being available to accommodate the hourly swings possible with such service.

While many pipelines have marketed tailored services to meet the unique needs of their customers, including gas-fired generators, customers, in many cases, appear to lack the incentive and the ability to subscribe these services. Without such commitments, a requirement to offer such services on a generally available basis would compel the holders of firm capacity – principally local distribution companies (LDCs) and industrial end users – to subsidize the cost of pipeline facilities (and information technology and other capabilities) that they do not require and have not requested.

4. Pipeline services cannot create liquidity in the intraday market if no gas commodity has been allocated to the additional opportunities for nominations.

Liquidity cannot be created by regulatory fiat. Simply requiring jurisdictional interstate pipelines to alter tariffs and abbreviate the nomination, confirmation and scheduling timeline will not create significant liquidity in the intra-day market. The economic fundamentals driving the behavior of the producers and marketers that sell gas in the decontrolled commodity market will determine whether any significant quantity of gas is available in the intra-day market.

At the September 18 meeting and in other forums, producers have described the economic fundamentals that affect their operating practices and decisions concerning the sale of natural

gas. Gas wells are either flowing or shut in. When a well is not flowing, the revenue from the production is deferred to the end of the productive life of the well. As a result, the economic risk for the producer is minimized by producing wells as rapidly as possible and committing the gas to a purchaser as early as possible. A producer can minimize risk by ensuring that the vast majority of daily production is nominated in the Timely cycle.

Producers will not change this behavior unless they expect that prices in the intra-day market will be consistently higher than the price for gas sold in the Timely cycle. Indeed, the price in the intra-day market would need to be enough above the price in the Timely cycle to offset the risk that producers will be unable to sell the entire production stream.

Consequently, unless the behavior of the producers and marketers changes, with more gas reserved for the intra-day market, there will be little, if any, incremental supply available for intra-day purchasers of gas. Any gas that is available will be gas that has been reallocated from other gas purchasers.

With the backdrop of the regulatory obligation to serve and with the oversight of state commissions, LDC gas supply plans are constructed to provide gas reliably to the LDC's customers at the lowest sustainable cost. LDCs do not purchase supply with the intent of selling gas back to the market to create profit. The gas that may not be required on any given day is managed through the use of storage.

Industrial customers manage gas purchases as an input cost in their industrial process. Industrial customers do not speculate by acquiring excess gas supply in the hope of creating profit.

Additionally, the requirements of gas customers are correlated within a constrained geographic market. On a cold winter day or other high demand period, the LDC, the industrial customer and the electric generator all experience larger than average gas requirements. As a result, within such a market, the supply available to create liquidity in the intra-day market is limited and extremely inelastic. Very large price movements still will be required and only a limited number of transactions will likely occur in such a highly constrained market.

5. The scope of the problem is unclear.

Before considering whether to pursue further the concept of the centralized trading platform (or any other proposed fix), the scope of the problem must be weighed against the cost of the proposed solution. How many matches/bids/offers for natural gas are going unfulfilled and to what degree can this be attributed to the current nomination, confirmation and scheduling timeline? Would the benefits that could be achieved outweigh the costs of reforming the current timeline? What would be the equities of implementing such reforms, i.e., would the beneficiaries pay the costs associated with creating the benefits?

Under the current market structure, gas marketers have an economic incentive to meet the needs of gas consumers. Moreover, marketers have the ability to design gas supply and delivery options that meet the needs of customers, including power generation customers. There is no reason to believe that marketers will not continue to evolve their product offerings to capture a larger percentage of all potential transactions.

6. It does not appear that a centralized trading platform could be created via only incremental changes to the current natural gas pipeline model.

While the proposal put forward by AF&PA does not include many details, there is reason to believe that implementation of the trading platform would require significant changes to natural gas transportation policies and regulations. Questions include the following:

Will natural gas transportation services need to be standardized and redesigned in order to identify "feasible pairs" of receipt and delivery points across pipelines? Exchange traded markets require homogenous products. Yet, current pipeline transportation services differ based on the capabilities of individual pipelines and the needs of customers.

What would be the consequences of homogenizing pipeline transportation products? Would it degrade the quality of service on pipelines that now offer enhanced services? What would it mean for pipelines that would need to enhance their services to get over the bar? Would they need to reduce their firm transportation capacity in order to be able to offer the enhanced service?

How would one define the area over which the trading platform administrator would preside? Is the inevitable conclusion a nationwide ISO for interstate natural gas pipeline capacity? Pipelines do not correspond with individual ISO/RTO wholesale power markets. Some pipelines cross multiple ISO/RTO and bilateral wholesale power markets. Some pipelines operate in both the Eastern and Western interconnections. What about pipelines that cross international borders? Given these questions, it does not appear that creation of a centralized trading platform could be achieved with merely incremental changes to the current model for natural gas pipeline services.

7. Even if implementation of the centralized trading platform is feasible, it would not provide a means to relieve pipeline infrastructure constraints that affect the ability to serve electric generators during periods of high demand for natural gas.

The trading platform will not create capacity where there is none on a capacity-constrained pipeline. In fact, it can be argued that homogenizing pipeline transportation products and relinquishing control of the pipeline network to the administrator of the trading platform would dampen the incentive for shippers to commit to the long-term firm contracts needed to underpin new infrastructure investment.

Respectfully submitted,

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DATE: October 1, 2014