UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Staff Report on Capacity Release Docket No. RM08-1-000

NOTICE OF STAFF PAPER

(January 31, 2011)

Take notice that the Commission's Staff is posting a Staff Report presenting analysis of capacity release transactions (attached). Order No. 712 directed "staff to monitor the capacity release program and, using all available information, issue a report on the general performance of the capacity release program, within six months after two years of experience under the new rules." [1]

Questions regarding this Notice should be directed to:

Christopher Ellsworth
Office of Enforcement
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426
202-502-8228
Christopher.Ellsworth@ferc.gov

Kimberly D. Bose,
Secretary.

---

[1] *Promotion of a More Efficient Capacity Release Market*, Order No. 712, 73 Fed. Reg. 37,058 (Jun. 30, 2008), FERC Stats. & Regs. ¶ 31,271 at P 56 (2008), *order on reh'g*, Order No. 712-A, 73 Fed. Reg. 72,692 (Dec. 1, 2008), FERC Stats. & Regs. ¶ 31,284 (2008), *order on reh'g*, Order No. 712-B, 127 FERC ¶ 61,051 (2009).

Staff Report on Capacity Release

Overview

On June 19, 2008, FERC issued Order No. 712, which removed the price cap on short-term (less than one year) capacity releases on interstate natural gas pipelines.[1] Order No. 712 also modified the capacity release rules to facilitate the use of asset management agreements (AMAs) where a party agrees to manage gas supply and delivery arrangements, including transportation and storage capacity, for another party. In Order No. 712, the Commission directed "staff to monitor the capacity release program and, using all available information, issue a report on the general performance of the capacity release program, within six months after two years of experience under the new rules."[2]

All data utilized in this report was obtained from an outside vendor,[3] one of the multiple data sources the Commission's Office of Enforcement uses to oversee energy markets. This particular vendor utilizes a proprietary tool that allows the company to "scrape" each natural gas pipeline's Electronic Bulletin Board (EBB) and obtain capacity release information. The Capacity Release Report study period (2007-10) included 80,300 lines of data obtained from 73 different pipelines.[4]

This report adds to and updates staff's initial review of the capacity release program after Order No. 712 which was included in the 2009 State of the Markets report. In the current report, staff compared annual capacity release data prior to the lifting of the price cap (2007-08) to annual capacity release data post Order No. 712 (2008-09 and 2009-10).

---

[1] *Promotion of a More Efficient Capacity Release Market*, Order No. 712, 73 Fed. Reg. 37,058 (Jun. 30, 2008), FERC Stats. & Regs. ¶ 31,271 (2008), *order on reh'g*, Order No. 712-A, 73 Fed. Reg. 72,692 (Dec. 1, 2008), FERC Stats. & Regs. ¶ 31,284 (2008), *order on reh'g*, Order No. 712-B, 127 FERC ¶ 61,051 (2009).

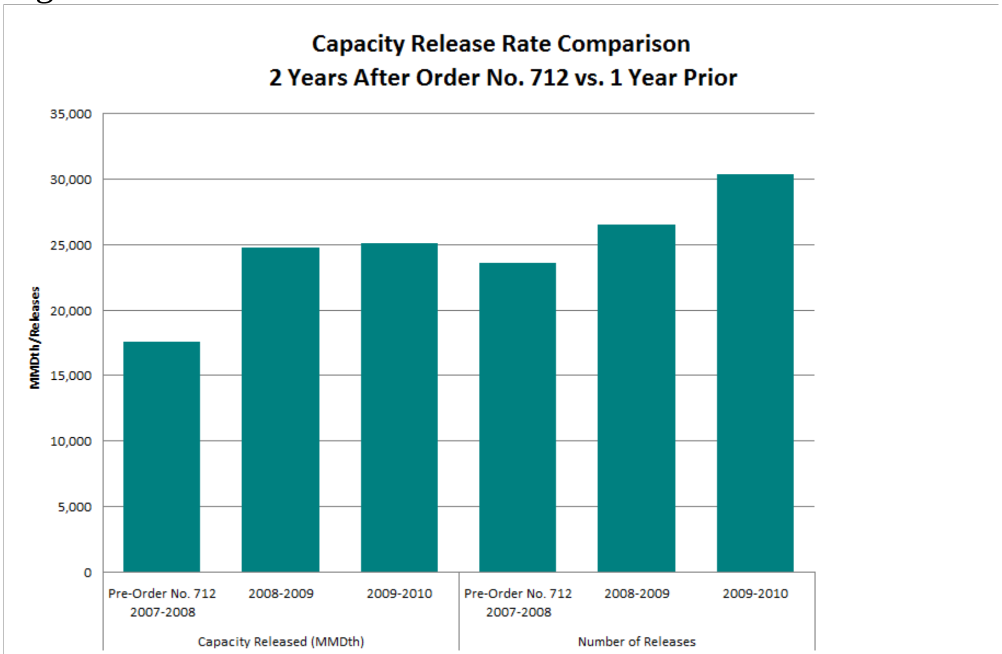
[2] Order No. 712 at P 56.

[3] Energy Velocity, LLC.

[4] The Commission requires pipelines to provide notice of the release pursuant to 18 CFR section 284.8(d). In addition, the details of the release transaction would have to be posted on the pipeline's Internet web site under 18 CFR section 284.13(b)(1)(viii), which requires the posting of "special terms and conditions applicable to a capacity release transaction."

Since the effective date of Order No. 712, the number of releases has grown by 29 percent. In the year before Order No. 712, there were approximately 23,500 releases, while during 2008-09 there were approximately 26,500 releases and 30,000 in 2009-10 (Figure 1). Not only did the number of releases increase, but the amount of capacity released has increased by 43 percent.[5]

Figure 1



Source: Energy Velocity, LLC.

Order No. 712 is likely not the cause of increasing capacity releases overall since August 2008. Nor is it likely the reason for a decline in higher priced releases. The order was issued just before the credit crisis in September 2008, which reduced gas demand and freed up capacity on natural gas pipelines. Order No. 712's issuance also coincided with a considerable increase in installed pipeline capacity—approximately 32 Bcfd of pipeline capacity has been added since November 2008. One of the most notable new pipelines is Rockies Express (REX), which sources gas in the Rockies and transports it to markets in the Midwest and Northeast. The opening of REX resulted in reduced flows and capacity requirements on long haul pipelines from the Gulf Coast. The increase in pipeline capacity and growth in new supply basins, such as the Marcellus and Haynesville shales, has also caused significant shifts in gas flows away from established

[5] In order to standardize the measurement of capacity releases across all durations, this report measures releases by the total capacity released (MMBtu per day) over the duration of the release (days).

pipelines on to new ones serving different regions. Those shifts would also free up pipeline capacity on older pipelines.

Nonetheless, Order No. 712's facilitation of Asset Management Agreements (AMA), where a releasing shipper agrees to allow another party to manage its gas supply and delivery arrangements, may have had an effect, increasing the number of transactions of longer duration.

The Effects of the Price Cap

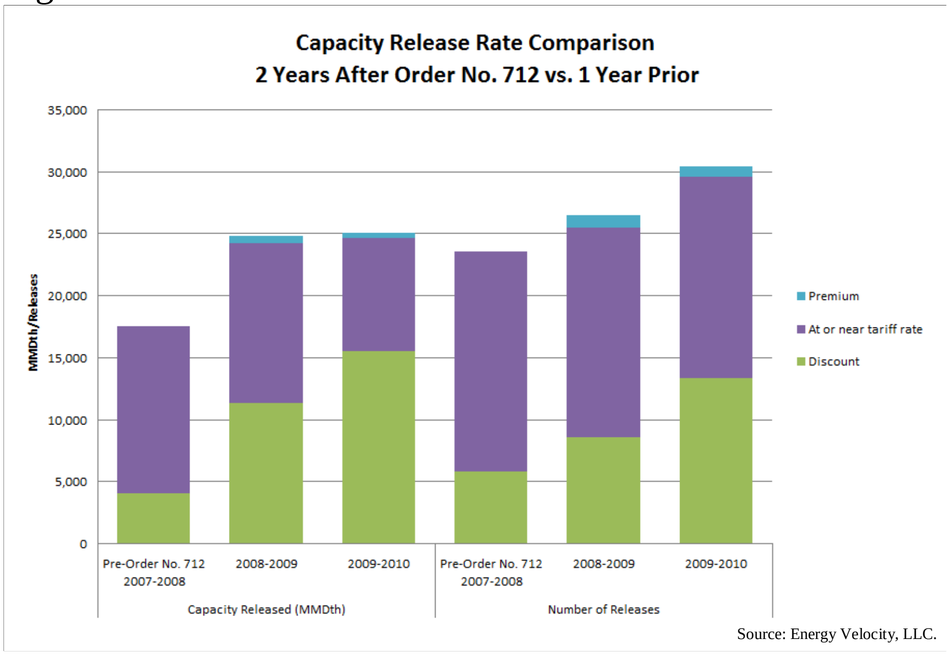
One significant concern regarding the lifting of the price cap was that, without the cap, the price of capacity releases could increase considerably. In order to better understand the effect of lifting the price cap, staff compared above-cap premium releases[6] and releases at or near the cap to identify distinctions between the two before and after the cap was lifted. If the cap was having a significant impact on the market, one might expect that lifting the cap would have an effect on releases priced at or near the cap's constraint.[7]

While released capacity and the number of releases increased overall following the issuance of Order No. 712, the growth has occurred in discounted releases. The volume and number of releases at, near, or above the tariff rate shrank after Order No. 712 (Figure 2). In the time period since the price caps were lifted, above-cap premium releases have represented less than 3 percent of the overall market, both in terms of the number of releases and the amount of capacity released. This is more than offset by the decrease in the undiscounted releases.

[6] For the purposes of this report staff considered above-cap premium releases to be equal to or greater than 102 percent of the tariff rate.

[7] To better capture the variation in capacity release prices and to account for potential inaccuracies in the way release prices are reported and summarized, this report has classified release prices as "discount" (meaning the price was up to 98 percent of the tariff rate), "at or near tariff rate" (meaning the price was between 98 and 102 percent of the tariff rate), and "premium" (the price was greater than 102 percent of the tariff rate).

Figure 2

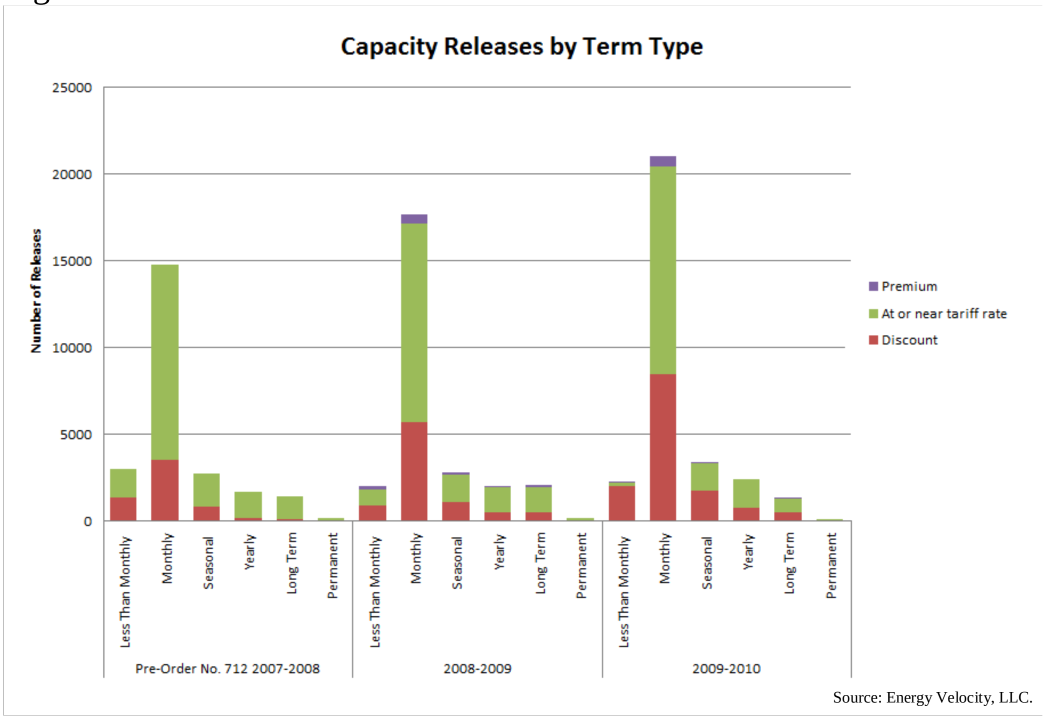


Release Duration

Because the price cap was retained for releases of greater than a year, [8] it might be expected that Order No. 712 could have encouraged more releases of less-than-one-year duration to capitalize on the unconstrained prices. However, Order No. 712 seems to have had little effect on the duration of releases. In the year before the effective date of Order No. 712, 13 percent of the releases exceeded a year. Since Order No. 712 became effective, 14 percent have exceeded a year. Before Order No. 712, most of the capacity releases (63 percent) were for a month; 12 percent were for less than a month; and 7 percent were for a year (Figure 3). In the two years since Order No. 712, 69 percent were monthly, 7 percent were less than a month, and 8 percent were for a year.

[8] Order No. 712 at P 79.

Figure 3



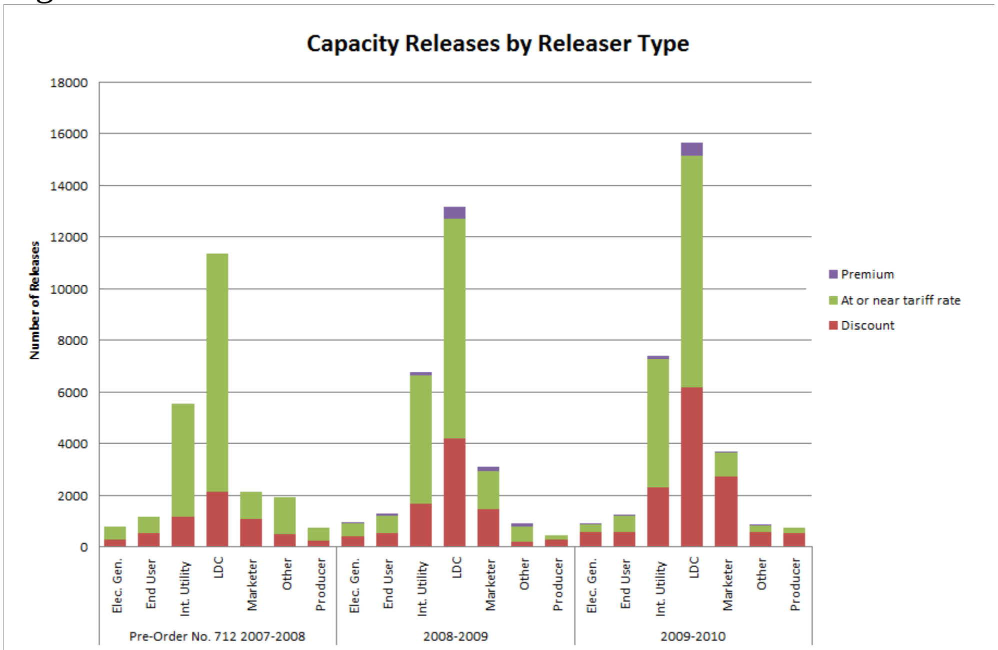
Releasing Shippers

Because the removal of the price cap allowed market forces more freedom to set the price of capacity releases, it is relevant to identify which market participants have been able to take the most advantage of premium pricing when selling capacity.[9] Local distribution companies (LDCs) conducted more capacity releases than any other category: 48 percent of the releases before the rule in 2007-08, 50 percent of the releases in 2008-09 and 51 percent in 2009-10 (see Figure 4). LDCs also made up the highest percentage of above- cap premium releases, 45 percent in 2008-09 and 60 percent in 2009-10. Integrated utilities accounted for another 16 percent of above-cap premium releases in 2008-09 and 18 percent in 2009-10. The total number of releases by LDCs and integrated utilities rose by 36 percent between 2007-08 and 2009-10. Gas marketers made up 9 percent of total releases prior to Order No. 712, compared to 12 percent in 2009-10. In 2009-10 marketers made up 7 percent of above-cap premium releases. It appears as if LDCs and integrated utilities benefit from above-cap premium releases in roughly the same proportion to their participation in the release market.

---

[9] Source, Energy Velocity. Energy Velocity's designations of shippers as Gas Utilities are interpreted to mean the company is an LDC. Utilities that list Electric and Gas as their Industry are interpreted to mean that the company is an Integrated Utility.

Figure 4



Source: Energy Velocity, LLC.

Asset Management Agreements

In Order No. 712, the Commission created exemptions to the capacity release rules to accommodate the development of AMAs. The Commission stated:

> AMAs are contractual relationships where a party agrees to manage gas supply and delivery arrangements, including transportation and storage capacity, for another party. Typically a shipper holding firm transportation and/or storage capacity on a pipeline or multiple pipelines temporarily releases all or a portion of that capacity along with associated gas production and gas purchase agreements to an asset manager. The asset manager uses that capacity to serve the gas supply requirements of the releasing shipper, and, when the capacity is not needed for that purpose, uses the capacity to make releases or bundled sales to third parties.[10]

In order to facilitate the development of AMAs, Order No. 712 exempted them from the bidding requirements that apply to most other capacity releases. To qualify for those exemptions, AMAs are defined as prearranged releases with specific minimum

[10] Order No. 712 at P 110.

delivery and/or purchase obligations.[11] These conditions were intended to distinguish releases under legitimate AMAs from other releases that would still be subject to the standard bidding rules.

Order No. 712 required that capacity release postings related to an AMA should identify the asset manager and the delivery or purchase obligation of the AMA. Order No. 712 also stipulated that the information posted should "specify the volumetric level of the replacement shipper's delivery or purchase obligation and the time periods during which that obligation is in effect."[12] Because this information is identified as a special condition applicable to a capacity release transaction under 18 CFR § 284.13(c)(2)(viii) (2010), it is provided in a manner that makes it difficult to assess without looking at each release posting on every pipeline. An estimate of AMA related releases could be obtained by comparing customer/agent information in the index of customers to releaser/bidder information associated with prearranged capacity release postings.[13] Due in large part to the difficulty in making a sound determination of what constitutes an AMA release, staff was unable to accurately assess the impact of AMA releases for this report.

Version 1.9 of the standards promulgated by the Wholesale Gas Quadrant of the North American Energy Standards Board took effect in November 2010. The formulation is consistent with the way the standards have been referenced in other Commission orders. There is now a data field located in the electronic data interchange datasets that identifies an individual release as an AMA. Previously, individual pipelines may or may not have reported this in the comments field of the capacity release agreement posted on their individual EBBs. Moving forward this new requirement will enable staff to analyze the AMA portion of the capacity release market. It will take some time before a sufficient amount of data becomes available for analysis. Once that data is available, staff will update the Commission.

---

11 Order No. 712 at P 141. The bidding exemption and the definition were clarified in Order No. 712-A.

12 Order No. 712 at P 175.

13 This estimate would tend to overstate the number of releases because it is possible to release capacity to an "agent" identified in the index of customers outside an AMA. A more precise estimate would require reviewing archived posting materials from individual pipelines.

Conclusions

- There has been no discernible positive or adverse impact on the capacity release market from Order No. 712. Any discernible market impact from Order No. 712 is likely overwhelmed by changes in the gas market itself because of the recession, growth in gas supply from new regions, significant expansion and reconfiguration of the pipeline grid, and resulting utilization of pipelines.

- Since the lifting of the price cap the number of releases has grown by 29 percent and the amount of capacity released has grown by 43 percent. Much of this is because of changing utilization of pipelines due to changing supply sources and new major pipeline additions.

- Removal of the price cap has not had a significant impact on pricing. In fact above-cap premium releases make up less than 3 percent of the overall market.

- There has been little change in the duration of releases. Monthly releases make up 69 percent while long term releases account for 5 percent.

- LDCs and Integrated Utilities continue to hold the largest market share (51 percent and 16 percent, respectively) in terms of releasing shippers: Natural gas marketer share in this category has grown only slightly over the last two years (12 percent).

- Moving forward, staff will analyze capacity release data with regard to AMAs under the new NAESB standard 1.9 that took effect in November 2010.

Document Content(s)