BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Pacific Gas and Electric Co. **Southwest Gas Corp.**	**Docket No. RM06-21-000**
Coral Energy Resources, L.P. **Chevron U.S.A., Inc.** **Conoco Phillips Co.** **Constellation Energy Commodities Group, Inc.** **Merrill Lynch Commodities, Inc.** **Nexen Marketing U.S.A., Inc.** **Tenaska Marketing Ventures** **UBS Energy LLC**	**Docket No. RM07-4-000**

COMMENTS OF THE NATIONAL ENERGY MARKETERS ASSOCIATION

The National Energy Marketers Association (NEM)[1] hereby submits comments on the Commission's capacity release program pursuant to the January 3, 2007, Request for Comments and the March 6, 2007, Notice of Extension of Time issued in the above-referenced proceedings. NEM offers a unique perspective to this proceeding as a representative of wholesale and retail market participants, amongst others. NEM submits these comments to recommend modifications to the capacity release program that will support the further development of the competitive retail natural gas markets.

The functioning of the wholesale and retail gas markets are inextricably intertwined. This fact, coupled with this Commission's jurisdiction over local distribution companies'

[1] NEM is a national, non-profit trade association representing wholesale and retail marketers of natural gas, electricity, as well as energy and financial related products, services, information and advanced technologies throughout the United States, Canada and the European Union. NEM's membership includes independent power producers, advanced metering, demand and load management firms, billing, back office, customer service and related information technology providers. NEM members are global leaders in the development of enterprise solution software for energy, advanced metering, information services, finance, risk management and the trading of commodities and financial instruments. NEM members also include inventors, patent holders, systems integrators, and developers of advanced power line surveillance and grid reliability technology with advanced uses in Power Line Communications (PLC) technologies as well as new and innovative electrical applications known as Smart Electricity.™

(LDCs) assignment of interstate pipeline capacity in the context of retail unbundling programs, provides the Commission with the authority and the opportunity in this proceeding to identify capacity release program policies that are consistent with, and will promote the development of, competitive retail gas markets. Given the complexity of these issues, NEM respectfully requests that the Commission convene a technical conference to engage the entire stakeholder community in an open dialogue about capacity release program improvements.

1. FERC's Capacity Release Policies Should Be Consistent with and Promote Retail Market Development

This Commission has evinced its intent to implement policies consistent with retail natural gas market development since the early inception of retail choice programs. In its examination of Atlanta Gas Light's 1998 proposal to institute an Incremental Bundled Storage Service as part of a retail unbundling program, FERC stated that,

> Retail unbundling of natural gas services must be recognized as an important element in the evolving national energy market. To this end, the Commission intends to encourage an environment which will allow state commissions and local distribution companies to implement retail unbundling. The Commission thus is willing to consider limited departures from its regulations and policies that may be necessary to achieve retail unbundling at the state level. In considering requests for waivers, such as Atlanta's, the Commission must weigh the need for waiver to accomplish unbundling against any potential negative effect a waiver may have on the interstate gas market. The Commission also must recognize that various state commissions are considering a wide variety of retail unbundling proposals including alternative proposals dealing specifically with LDC retention of upstream pipeline capacity. The Commission's goal in making these determinations is to ensure an environment in which natural gas users can reap the benefits of both retail unbundling at the state level and the restructured interstate natural gas market created by Order No. 636.[2]

[2] 84 FERC 61,119, Docket No. RP98-206-000, Order Issuing Limited-Term, Limited Jurisdiction Blanket Certificate, Amending Certificates for a Limited Term, and Granting Temporary Waivers, issued July 31, 1998, pages 4-5.

NEM appreciates the Commission's consideration of the interplay of retail and wholesale market development and how it's policy determinations have ramifications for retail choice programs. NEM urges the Commission to continue to be mindful of this linkage.[3]

More recently, the Commission reaffirmed that, "any reassignment of an LDC's capacity on interstate pipelines as part of a state unbundling program must conform to the Commission's capacity release regulations, absent a waiver of those regulations."[4] FERC's actions and policy determinations in this proceeding on capacity release programs will have a real impact on the development of retail gas choice programs. FERC policies are not implemented in a vacuum. FERC's efforts to promote competition in wholesale markets are directly tied to the functioning of retail markets.

In Order 637 establishing the current capacity release program, the Commission noted that retail unbundling for larger customers was relatively advanced while residential retail unbundling was, "still in its infancy."[5] "As of 1998, the percentage of customers unbundled at the retail level were: industrials – 84.5%, electric utilities – 66.1%, other end users – 49.3%, commercial customers – 33%, residential customers – 2.3%."[6] Today, in contrast, over 50% of residential customers are eligible to participate in retail choice programs, and approximately 12% percent of those customers (approximately 4.2

[3] For instance, the New York Public Service Commission recently issued an inquiry into capacity planning and reliability in NYPSC Case 07-G-0299. One of the issues for study in the case is the availability of Dominion Transmission's (DTI) Delivery Point Operator/Citygate Swing Customer (DPO/CSC) service. Marketers using the program are allowed access to storage assets on DTI to balance winter deliveries and for price arbitrage. The advisability of expanding the program to other interstate pipelines is an example of a retail issue that FERC and the NYPSC can coordinate and facilitate.

[4] Georgia Public Service Commission, 110 FERC ¶ 61,048 at 7 (2005). Additionally, in its review of Fitchburg Gas and Electric Light Company's implementation of state Commission's retail unbundling program calling for mandatory assignment of upstream capacity, FERC stated that, "assignment of capacity on interstate pipelines is subject to the Commission's capacity release regulations." 94 FERC 61,006, Case RP01-87-000, Order on Complaint, Order on Complaint, Jan. 10, 2001, page 7.

[5] 90 FERC 61,109, Order 637, pages 8, 29-30.

[6] Id. at page 8, fn. 10.

million) have migrated to a retail marketer.[7] NEM submits that this marked increase in the availability of and participation in retail choice programs merits the Commission's consideration. Given the interrelationship between the wholesale and retail gas markets, coupled with the increase in retail choice, NEM urges that capacity release program rules should be updated to simultaneously facilitate the continued growth of both markets.

2. FERC Should Endorse the Policy that "Assets Follow the Customer"

In capacity constrained markets, shipper releases of capacity, particularly from LDCs, are the predominant source of capacity for retail marketers. NEM urges that pipeline capacity from LDCs must be made available to energy marketers for customers who switch. NEM recommends that as individual customers leave a utility's system supply for that of a competitive supplier, the customer should be assigned capacity, and it should be accomplished under the same terms and conditions as that customer would have received as a utility sales customer. Assets should be made available on a non-discriminatory basis, both in terms of allocation and utilization rights. In other words, assets should follow the customer. This ensures that customers have equal access to the assets for which they pay. Because FERC has jurisdiction over the assignment of interstate pipeline capacity,[8] it is within this Commission's purview to establish such a policy. In a retail choice environment, utilities need only retain those assets sufficient to meet their remaining firm commodity customer needs and to assure distribution system integrity on peak day and through the design winter period.

Utility capacity assets are paid for both through base rates and through balancing and peaking fees paid for by migrated choice customers. For example, a utility may permit

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[7] Energy Information Administration, Status of Natural Gas Residential Choice Programs 2006.
[8] Georgia Public Service Commission, 110 FERC ¶ 61,048 at 7 (2005).

retail suppliers to deliver gas in a relatively flat or consistent level throughout the year, even though typically small commercial and residential customers consume gas in more significant quantities during the heating season than the rest of the year. In order to permit this latitude in delivery without requiring a peak day delivery greater than the base load amount, such utilities will charge a fee that permits the utility to acquire or utilize storage and delivery assets necessary on a peak day to supply choice customers. However, on all other days, the firm assets paid for by choice customers are not being fully utilized, and therefore are available for the utility to leverage to generate revenue. Marketers are not permitted access to these assets to take advantage of the same opportunities. Either through design or agreement, the revenues from these sales are either retained by the utility, or more likely are being shared between the utility and the sales customers. The result of this practice is that assets paid for by choice customers are being used to generate revenue, and the revenue is being used to subsidize sales customers. This creates an inequity in the market and stifles competition.

A similar but distinct issue involves the balancing fee and related assets themselves. Often, utilities retain assets on behalf of sales customers and as migration occurs, instead of releasing the assets to the choice suppliers for use on behalf of those migrated choice customers, the assets are retained. Although in many instances the balancing services that are provided do not include a peaking service, rather daily balancing only, the full cost of the assets are passed onto the choice customer or choice supplier. On and approaching a peak day, the assets that were being used for balancing (to some extent) begin to be used for delivery needs of sales customers, since as a peak day approaches, less balancing is needed and more of those assets are needed to serve the needs of sales

customers. On a peak/design day, no balancing is occurring since all assets are being fully utilized to meet firm need (by design). However, in all instances where a peaking service or reduced demand curve is not provided, the choice-paid-for assets are being used to provide sales customers' needs or engage in capacity transactions that do not benefit the choice customer who paid for the assets.

The solution to these problems is to permit retail marketers to have access to the assets for which their customers pay year round. In turn, marketers could optimize their utilization of assets in a manner similar to that of the utility.

If this Commission adopts the "assets follow the customer" capacity construct proposed by NEM, this will do much to satisfy NEM's concerns set forth below concerning the shipper must take title rule. It is NEM's preference that the "assets follow the customer" construct be adopted. However, in the absence of this capacity construct, NEM strongly urges that the shipper must take title rule be eliminated.

3. FERC Should Eliminate the Shipper Must Take Title Rule

In Order 637, the Commission noted that the "shipper must have title policy" predates the Commission's capacity release program established in Order 636 and was developed in the proceedings to implement Order 436.[9] The Commission characterized the purpose of the capacity release rules as assuring "nondiscriminatory, efficient allocation of capacity with transparency."[10] The Commission further opined that, "Without the shipper must have title policy, it is unlikely that shippers would need to use capacity release because capacity holders could simply transport gas over the pipeline for another entity. These

[9] Order 637 at 124.
[10] Order 637 at 125.

transactions would not be subject to any of the capacity release requirements, such as the reporting requirements or the allocation rules. Without the shipper must have title rule, the identity of the users of the pipeline's transportation and the conditions under which they moved gas would not be known."[11] However, the Commission did concede that it is possible to revise the capacity release program, to eliminate the shipper must have title policy, and still promote its purposes.[12] The Commission also noted that its current policy has attendant transaction costs.[13]

NEM believes that the shipper must have title policy is inconsistent with the current and future development of the retail natural gas markets. Although the state of retail market development at the time of Order 637 may not have justified a change in the shipper must have title rule, NEM submits that the more advanced state of retail gas choice should be factored into the Commission's deliberations on this issue today.

In the majority of jurisdictions implementing gas choice, the utility remains the supplier of last resort. Many jurisdictions have contemplated a market end state in which the utility will ultimately exit the merchant function. However, aside from the Atlanta Gas Light program and an on-going multi-step approach by Dominion East Ohio to exit the merchant function, other gas utilities have been caught in regulatory "limbo" of sorts as they feel they lack the regulatory certainty to exit the merchant function. The utilities structure their assets, including long-term, firm contracts with interstate pipelines, so as to be deemed to be prudently and reliably effectuating their supplier of last resort role by their local Commission. In comparison, retail gas marketers, for a variety of reasons

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[11] Order 637 at 124.
[12] Order 637 at 125.
[13] Id.

generally do not have access to comparable capacity to that of the utility. And so, utility capacity release programs are a reality of retail gas choice programs. Moreover, it is likely that this will be true for some time as consumer migration continues and state Commissions continue to approve transitional retail market development programs that keep utilities in the merchant function (regardless of whether this is economically rational for gas utilities to do since they are prohibited from earning a profit on commodity) for some undefined interim period.

Recognizing this to be the case, NEM urges the Commission to adopt capacity release constructs that permit gas utilities to offer and construct capacity release programs that are consistent with and promote the development of retail gas choice programs. The shipper must have title rule impinges on forward-thinking utilities' ability to design marketer-friendly capacity release programs and on a broader level limits the marketability of capacity and potentially interferes with the ability to construct "merchant function exit" strategies such as that being developed in Ohio, the result of which is an arms-length, competitively bid price and retail release of customers that, due to the nature of the assets and comfort of the local Commissions, may require utilities to continue to hold the capacity while permitting the suppliers to utilize the assets, whether on an actual release or through other unique and creative capacity programs. If the ultimate result is an arms-length, competitive bid and resulting market price, it certainly seems that fundamental tenets of the FERC Orders are upheld.

NEM believes it is possible to continue to promote, "nondiscriminatory, efficient allocation of capacity with transparency" without the shipper must have title construct. The Commission's quoted explanation above of the need for the shipper must have title

construct is to ensure that transactions occur within its capacity release program construct. There are other ways to accomplish this objective. Strict enforcement of standards of conduct prevents affiliate releases that are not competitively neutral. Likewise, posting and reporting requirements serve to provide necessary transparency. Efficient allocation of capacity is promoted through rules that inhibit the exercise of market power.

As noted above, it is NEM's preference that the Commission adopt the capacity construct that "assets follow the customer." However, if such a policy is not adopted, NEM recommends that elimination of the shipper must take title rule would accomplish many of the same goals in furtherance of competitive retail market development.

4. The Maximum Rate Cap on Capacity Releases Should Not Be Removed Without Affirmative Evidence that Market Power Concerns Are Not an Issue and Consumers Adequately Protected

The Commission posed the question as to whether the maximum rate cap on capacity releases should be lifted. NEM submits that removal of the maximum rate cap must be predicated on a Commission finding that the market is sufficiently competitive to prevent the exercise of market power in capacity release markets and the setting of unjust and unreasonable rates.[14] This is central to the Commission's charge to protect consumers. For example, NEM suggests that the Commission should examine LDCs' control over citygates (primary market delivery points) and their attendant potential to exercise market power to impede retail competition. If, after having conducted this review, the

[14] Natural Gas Act, 15 U.S.C. § 717c (a) provides that, "All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful."

Commission finds there is a lack of market power or that market power has been sufficiently mitigated, then the Commission can consider removing the maximum rate cap. The record for removing the maximum rate cap would be incomplete without affirmative proof of these market conditions.

5. The Characterization of A Transaction as Improper Tying Should Be Informed by the Openness and Transparency of the Arrangement

In one of the petitions prompting the Commission's request for comments, a group of wholesale marketers asked for clarification of Commission policies as they relate to portfolio management services.[15] In particular, the petition requested clarification of whether certain practices constituted improper tying. The petition related how portfolio management agreements may include prearranged releases of capacity in association with supply or purchase agreements or may include prearranged releases of capacity on an aggregated basis on the same or multiple pipelines. The petitioners assert these types of arrangements are "legitimate, beneficial and economic transactions" and are appropriate given the increased maturity of the market.

NEM agrees that regulatory certainty in portfolio management rules is essential. Additionally, as wholesale and retail markets mature, the nature of portfolio management services will evolve, and rules should be reviewed to ensure they promote reasonable and efficient commercial realities. This is evident in the recent wholesale auction process utilized by Dominion East Ohio for provision of a Standard Service Offer to retail customers in its service territory.[16] In some instances the portfolio managers are not

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[15] Docket Nos. RM91-11-009 and RM98-10-013, Petition for Clarification of Coral Energy Resources et. al., Oct. 20, 2006.

[16] PUCO Case No. 05-474-GA-ATA, Application of Dominion East Ohio for Approval of a Plan to Restructure its Commodity Service Function.

selected through an arms-length, competitive bidding process, rather the assets are simply handed over to the utility's affiliate or without an open, well-noticed competitively neutral process. If this is the case, the assets are not being managed by a third party as a result of such process and certainly should raise questions concerning the appropriateness of the transaction or related releases. Also, in any instance, portfolio management contracts need to include provisions that permit the assets to continue to be used by the customer as the customer migrates, so that customers can migrate without the losing the value of assets for which they pay.

The core issue in NEM's view as to whether these arrangements are permissible or improper tying is the degree of transparency and openness in the availability of the capacity. Capacity arrangements should be subject to an arms length, competitive bidding process to promote market transparency. In the absence of this, improper tying issues may remain. Moreover, as NEM suggested above, contracts should permit assets to follow the customer.

6. Request for Technical Conference and Conclusion

NEM appreciates this opportunity to comment on the Commission's capacity release program and potential improvements that could enhance the development of the competitive retail gas market. Given the scope and complexity of the issues involved with a change in FERC's capacity release rules, as well as the impact that such changes could have on the retail market, NEM respectfully requests that the Commission convene a technical conference to receive further stakeholder input. NEM and its policy

leadership would be pleased to participate in a technical conference to aid the Commission in its review of the capacity release rules.

Respectfully submitted,

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