E-ALERT | Energy

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FERC SEEKS COMMENT ON ADDING RESTRICTIONS ON INTRASTATE GAS PIPELINE CAPACITY TRANSFERS AND ADOPTS CREDIT REFORM RULE FOR ORGANIZED ELECTRICITY MARKETS

On October 21, 2010, FERC issued a Notice of Inquiry (NOI) seeking comments on whether and how holders of firm interstate capacity on some intrastate gas pipelines can allow others to use their capacity, including to what extent buy/sell transactions should be permitted. Also on that date, FERC issued a final rule adopting reforms to credit policies used in organized wholesale electric power markets to balance the need for market liquidity with appropriate risk management while ensuring just and reasonable rates.

THE INTRASTATE GAS PIPELINE INQUIRY

Section 311 of the Natural Gas Policy Act permits intrastate pipelines to perform interstate service without becoming subject to FERC's Natural Gas Act (NGA) jurisdiction. In addition, the NGA exempts from FERC jurisdiction pipelines subject to state commission regulation that receive natural gas at or within their state boundaries that is consumed within the state; these pipelines are referred to as Hinshaw pipelines. While section 311 and Hinshaw pipelines that perform interstate services must do so on an open-access basis, FERC did not impose all of its open access regulations on them. For example, intrastate pipelines were exempted from the capacity release program.

The NOI responds to policy concerns raised by a July 2010 order concerning Arizona Public Service (APS) in which FERC ruled the prohibition on buy/sell transactions applies to section 311 and Hinshaw pipelines. A prohibited buy/sell transaction is where a shipper holding interstate pipeline capacity buys gas at the direction of, on behalf of, or directly from another entity, ships that gas through its interstate pipeline capacity, and then resells an equivalent quantity of gas to the entity at the downstream delivery point. While FERC noted that the buy/sell prohibition (and the shipper must have title rule) was adopted as part of the capacity release program, it also explained in the APS order that it plays a more fundamental role than preventing circumvention of the capacity release program. It stated that the prohibition helps enforce open-access requirements by ensuring that capacity is allocated among shippers in a transparent manner.

A number of stakeholders responded to the July 2010 order, arguing that it raised policy issues that should be addressed in a rulemaking proceeding. In the NOI, FERC asks questions regarding two possible policy actions:

- Applying the buy/sell prohibition to section 311 and Hinshaw pipelines
- Requiring section 311 and Hinshaw pipelines providing firm service to also allow capacity release

FERC granted a blanket waiver to allow existing and new buy/sell transactions involving section 311 and Hinshaw pipelines to continue to take place while it considers these policy issues. Further, FERC

said it will not institute any enforcement actions with respect to prior buy/sell transactions involving section 311 and Hinshaw pipelines in recognition of the pre-existing uncertainty of whether the buy/sell prohibition applied to those pipelines. It is important to note that while the blanket waiver applies to both existing and new buy/sell transactions, the statement regarding no enforcement action applies only to prior transactions.

Depending on the outcome, the NOI could have broad implications for section 311 and Hinshaw pipelines and their customers as it could lead to new rules on capacity reassignment arrangements on all section 311 and Hinshaw pipelines, including buy/sell transactions.

Comments to the NOI are due December 27, 2010. The NOI is available here.

THE CREDIT REFORM RULE

In its order adopting the final rule (Order No. 741), FERC noted that the efforts to develop credit policies by the several organized markets have been varied, leading to a wide range of risk management and creditworthiness practices among ISOs and RTOs. Because a default by one market participant is routinely socialized among all of the others in an ISO or RTO, FERC noted that this variable development of risk management practices has left many utilities at risk for a disruption in the market.

The credit reform rule requires organized wholesale power markets to:

- Shorten both the billing period and the period for payment to no more than seven days each.
- Reduce the allocation of unsecured credit to no more than $50 million per market participant and no more than $100 million per corporate family.
- Eliminate unsecured credit in all financial transmission rights (FTRs) markets.
- Establish minimum criteria for market participation, such as requirements related to adequate capitalization and risk management controls.
- Clarify the circumstances in which a market administrator may invoke a “material adverse change” and demand additional collateral from a market participant. Tariffs should eliminate ambiguity and state examples of which circumstances entitle a market administrator to invoke a “material adverse change” clause.
- Establish a grace period of no more than two days for “curing” collateral calls.

FERC also addresses the concern that, if a market participant files for bankruptcy protection, it may argue against setting-off amounts owed against amounts to be paid to an ISO or RTO, which could lead to a larger default in the market that must be socialized among all other participants. One way of addressing this concern is for the market to net or offset transactions, and FERC said it supported this option but was open to other ideas. The rule provides the following options:

- Establish a single counterparty to all market participant transactions.
- Require each market participant to grant a security interest to the organized wholesale electric market in the receivables of its transactions.
- Provide another method of supporting netting that provides a similar level of protection to the market.
- In the alternative, if the organized market does not adopt netting, it must establish credit based on market participants’ gross obligations.

The credit practices in the rule will be applied to all market participants, but FERC recognized that RTOs and ISOs may ask for exemptions. Each organized wholesale power market must make a filing to comply with the amended regulations or demonstrate that its existing tariff satisfies the new regulations.

The final rule takes effect November 26, 2010. FERC's Order No. 741 is available here.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our energy practice group:

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