Global Energy & Infrastructure | GT Alert

October 2015

FERC Clarifies Prohibition on Buy/Sell Arrangements

At the request of Rice Energy Marketing LLC, the Federal Energy Regulatory Commission (FERC), on Oct. 15, 2015, issued a Declaratory Order that clarified the extent to which releases of capacity to asset managers are exempt from FERC's prohibition on buy/sell transactions. As clarified, the exemption extends to volumes of gas purchased from the releasing shipper in a "supply asset management agreement" (supply AMA) as well as a "delivery AMA." "[T]he Commission clarifies that buy/sell transactions in which the releasing shipper in a supply AMA sells its natural gas to its asset manager, the asset manager transports the gas over the released capacity, and the asset manager then resells the natural gas to the releasing shipper are not buy/sell transactions of the type prohibited by Order No. 636." By so clarifying, FERC eliminated any question that the two types of AMAs stood on the same footing insofar as it concerns the exemption from the prohibition on buy/sell transactions.

The Declaratory Order effectively allows a releasing shipper in a supply AMA to use an asset manager solely to manage the releasing shippers' capacity, while continuing to market its own gas. By entering into a buy/sell transaction, producers and marketers can market their own gas and avail themselves of the benefits of an AMA without revealing sensitive competitive information to a competing marketer acting as an asset manager.

As part of its comprehensive restructuring of the interstate gas transmission industry in Order No. 636, the FERC set out its capacity release program as a means by which a firm shipper on an interstate pipeline can transfer unused and unwanted capacity to another shipper in a manner that is transparent and not discriminatory under the Natural Gas Act (NGA). Under the FERC's regulations, shippers must conduct capacity release transactions through the pipeline consistently with FERC-prescribed posting and bidding requirements.

To ensure that capacity holders and persons wishing to acquire capacity did not evade the requirements of the capacity release program, the FERC established several safeguards. Among these safeguards is the requirement that a shipper must have title to the gas transported in the shipper's capacity. Another safeguard is the prohibition on buy/sell transactions. In a buy/sell transaction, a shipper, *e.g.*, a local distribution company or "LDC," purchases gas in the production area from an end-user. The LDC, in this case, uses its capacity to transport the gas and sell the gas to the end-user at the delivery point on its system. The FERC found that buy/sell transactions would enable end runs of the requirement that capacity releases be conducted through the pipeline.

Recognizing the efficiencies that firm capacity holders were able to achieve by employing asset managers, the FERC in Order No. 712 exempted AMAs from the competitive bidding requirements of FERC's regulations, the prohibition against tying a release to an extraneous condition, and, at least to some degree, the prohibition on buy/sell transactions. An AMA is a contractual relationship by which a party, an asset manager, agrees to manage gas supply, delivery arrangements, and storage as well as transportation, for another party. Under an AMA, a holder of firm transportation capacity releases a portion or all of its capacity to the asset manager. The capacity holder may also assign gas production and sales contracts to the asset manager.

The Declaratory Order identified two types of AMAs: the delivery AMA and the supply AMA. Entities that purchase gas for use in their businesses, such as an LDC, typically use delivery AMAs. These entities hold interstate pipeline capacity for the purpose of transporting their gas to their premises. Under a delivery AMA, the capacity holder releases its capacity to the asset manager and may assign its gas purchase contracts to the asset manager. The asset manager then delivers gas to the releasing shipper when requested to do so. If not so requested, the asset manager either releases the unutilized capacity or uses it to make bundled gas sales to other purchasers thereby maximizing the value of the capacity often with the resulting revenues shared with the releasing shipper.

The releasing shipper under a supply AMA is typically a producer or a marketer, *i.e*., an entity that holds pipeline capacity to transport natural gas for sale in the market area. The asset manager may also take an assignment of the releasing shipper's gas sales contracts. Similar to a delivery AMA, an asset manager under a supply AMA will either purchase the releasing shipper's gas when requested to do so, or move the gas to points where the gas is sold. Here also, when the releasing shipper does not need the asset manager to purchase the releasing shipper's gas, the asset manager maximizes the value of the capacity.

Rice stated that while Order No. 712 clearly permitted such a buy/sell transaction as part of a delivery AMA, the Order did not address buy/sell transactions in a supply AMA. Finding that the rationale for permitting buy/sell transactions as part of delivery AMAs applies equally to supply AMAs, the Commission found that such transactions are not prohibited and granted the request for declaratory order.

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