In the wake of the country’s economic crisis, natural gas prices have dropped and the ability of many companies to obtain bank loans has become more difficult. Facing these issues, some natural gas energy companies may find it necessary to sell or monetize some of their gas supply assets. In transactions associated with rights to firm transportation capacity on interstate pipelines, buyers and sellers should be mindful of applicable Federal Energy Regulatory Commission (FERC) policies, for they are likely to come into play.

**PROHIBITIONS IN TRANSFERRING “TIED AGREEMENTS”**

Order 636-A specifically notes the following:

The Commission reiterates that all terms and conditions for capacity release must be posted and nondiscriminatory, and must relate solely to the details of acquiring transportation on the interstate pipelines. Release of pipeline capacity cannot be tied to any other conditions.

Sometimes economic and financial realities tie gas-supply agreements to specific capacity commitments on interstate pipelines. Notwithstanding its prohibition of such transactions, FERC has approved transfers involving unique situations where circumstances have necessitated the transfer of gas supply or other transportation agreements associated with firm pipeline transportation rights as a package.

In response to specific requests, FERC has granted waivers of its “tying prohibition,” where the parties have provided an open and transparent opportunity for other interested parties to participate in bidding on the same package of assets or agreements. In *Northwest Pipeline Corp. and Duke Energy Trading and Marketing, LLC*, Duke Energy Trading and Marketing (DETM) sought waivers of FERC’s prohibition against transferring transportation agreements that are tied to gas-supply agreements. The case also involved the aggregation of many transportation contracts (including cross-pipeline contracts) that would be transferred en masse. The transfer was proposed by DETM to significantly reduce the scope of its gas marketer business activities in the Intermountain West. Numerous primary and secondary capacity transportation agreements and associated gas-supply contracts were proposed to be transferred “intact,” with no change in contract rates or terms, to a prearranged purchaser.

DETM and Northwest Pipeline Corp. proposed a reverse-auction process to allow interested parties to bid on the package of assets. The commission approved the requested waivers, noting that “such an auction is an open and transparent manner in which to determine the value of the capacity released by DETM.” In approving the requested waivers, the commission clarified its policy concerning tying arrangements, stating the following:

In prohibiting tying arrangements, the Commission was primarily concerned with supply related tying arrangements such as an LDC requiring the potential replacement shipper to pay a certain price for local gas transportation service or a producer conditioning the release of capacity on the purchase of the producer’s gas. Here, because the contracts in question are
delivery contracts, the Commission’s concerns with the tying arrangement are somewhat alleviated and balanced by the fact the DETM’s gas delivery customers will receive the benefit of their bargain and their gas deliveries will be maintained even as DETM exits the business in a complete and orderly fashion (Ibid., at 61,204–61,205).

In Tennessee Gas Pipeline Co. and Dartmouth Power Associates LP, Dartmouth Power Associates Limited Partnership wanted to transfer its transportation capacity held with Tennessee Gas Pipeline and Iroquois Gas Transmission along with gas-delivery contracts in an aggregated sale as Dartmouth Power was exiting the gas marketing business. Dartmouth Power had secured a prearranged replacement shipper and, along with Tennessee, proposed an auction process where interested third parties could bid against the prearranged release. The gas transportation contracts being proposed for transfer were described as “inextricably linked” with the dependent gas purchase and sales contracts that were also being proposed for transfer. The commission found the following:

[T]he releasing shipper presents a unique case not contemplated by the Commission in Order No. 636-A. . . . Here, . . . a shipper has proposed to release capacity in an open and transparent manner consistent with the Commission’s rules of capacity release, and in an attempt to exit the gas transportation business in an orderly manner, has proposed to include its release of pipeline capacity packaged with its gas delivery contracts.

. . . . [B]ecause the contracts in question are delivery contracts, the Commission’s concerns with the tying arrangement are somewhat alleviated and balanced by the fact that Dartmouth Power’s gas delivery customers will receive the benefit of their bargain and their gas deliveries will be maintained even as Dartmouth Power exits the business in a complete and orderly fashion.

The Commission finds that . . . Dartmouth Power’s proposal is a reasonable attempt to craft an open and transparent auction process under which the release of capacity will be awarded to the shipper that values it the most (Ibid., at 63,159).

In Wasatch Energy, LLC and Northwest Pipeline Corp., the commission was asked to waive its policy against the tying of jurisdictional transportation agreements on various pipelines with nonjurisdictional gas-supply agreements, storage park and loan agreements, and related gas-purchase agreements. Wasatch had entered into an agreement with a creditworthy purchaser as a prearranged replacement shipper. In order to accommodate Wasatch’s desire to sell substantially all of its gas marketing–related agreements as a single portfolio, a consolidated auction process was proposed. The commission found the following:

Here, Wasatch and Northwest have proposed an open and transparent auction process for the disposition of Wasatch’s operational portfolio, including a number of gas transportation contracts which will be transferred to the Prearranged Replacement Shipper or a third party bidder at Wasatch’s cost. The Commission will grant waiver of the Commission’s Order No. 636-A policy regarding the tying of gas delivery contracts to released transportation capacity since the sale of Wasatch’s entire operational portfolio as an integrated package will permit Wasatch to exit the natural gas business in an orderly and rational manner (Ibid., at 61,832).

Other transfers have also been approved where the commission has found unique circumstances warranting an exception in using the usual capacity-release mechanisms found within each pipeline’s jurisdictional tariff. In December 2008, in light of the downturn in the financial markets, UBS AG determined that it would reposition its investment banking division and exit the commodities business in the United States. UBS selected Barclays Bank PLC to acquire UBS’s natural gas purchase and sale agreements as well as its natural gas transportation and storage agreements. Through legal counsel, UBS and Barclays sought limited waivers of the commission’s policies that would apply to capacity releases and tied agreements for a 90-day period (including a waiver of the shipper-must-have-title policy) in order to expeditiously complete the proposed transfer of assets prior to year’s end. In an order dated December 30, 2008, the commission approved the request, noting the unusual circumstances and limited purpose of the waivers. However, the commission has not approved all requests for waiver that it has received. For
example, in *Wyoming Interstate Co., Ltd.* and in *Cheyenne Plains Gas Pipeline Co., LLC,* proposed waivers of the commission’s tying prohibition were denied where firm transportation agreements at negotiated rates less than the posted maximum rates were going to be conveyed to specific parties without providing for others to bid on the capacity in an open and transparent bidding process.

FERC generally grants petitions seeking waiver of its tying prohibition and related pipeline tariff provisions so long as the following commission goals will not be compromised: (1) “all shippers have meaningful access to the pipeline transportation grid so that willing buyers and sellers can meet in a competitive national market to transact the most efficient deal possible” and (2) “consumers will have access to an adequate supply of gas at a reasonable price.”

**UTILIZATION OF COMMISSION-APPROVED CAPACITY-RELEASE MECHANISMS**

The transfer of capacity commitments on interstate pipelines, even when such commitments are not tied to gas purchase or sale agreements, must comply with commission policies concerning capacity release. Section 284.8 of the commission’s regulations requires that long-term firm capacity releases at a rate less than the maximum tariff rate must be posted for competitive bidding on a pipeline’s Electronic Bulletin Board. In discussing policies related to these posting requirements, the commission has said the following:

The . . . posting requirement for long-term, discounted rate releases promotes natural gas market transparency by providing notice to all interested shippers of the availability of released capacity. The competitive bidding requirement, in turn, ensures that the released capacity will go to the shipper who values it most. Together, the posting and bidding requirements are integral components of the Commission’s pipeline open-access program, and promote transparency, market efficiency, and the elimination of undue preference and discrimination in the natural gas transportation market (*BP Energy Co.*, 121 FERC ¶ 61,088, at 61,432 [2007]) (Order Approving Stipulation and Consent Agreement for an enforcement action resulting from self-reported violations of the commission’s capacity release and shipper-must-have-title policies that resulted in a $7 million civil penalty).

The commission’s efforts at policing its capacity-release policies to ensure market transparency and efficiency in any redeployment of interstate pipeline capacity commitments have become more visible. In March 2008, FERC’s Enforcement Office entered into a Stipulation and Consent Agreement with Constellation NewEnergy—Gas Division, LLC (CNE-G), to resolve a number of self-reported violations of the commission’s capacity release and related open-access policies.

CNE-G engaged in a practice known as “flipping.” Flipping involves a series of repeated short-term releases of discounted rate capacity to two or more affiliated replacement shippers on an alternating monthly basis in order to avoid the competitive bidding requirement for discounted long-term capacity releases. The effect of flipping is to create a long-term, non-competitive discounted rate release. . . .

CNE-G’s actions as a replacement shipper were deliberate and resulted in shielding the capacity that was release to CNE-G from competitive bidding. . . . The alternating monthly use of two affiliates as replacement shippers for the same capacity was implemented by CNE-G’s then-Vice President of Supply specifically for the purpose of circumventing the competitive bidding process for discounted, long-term released capacity (Ibid., at 62,240).

The Stipulation and Consent Agreement approved by the commission to resolve various self-reported violations of the commission’s policies required CNE-G to pay a $5 million fine and provide a payment of $1.9 million in disgorged profits. Other companies have also recently experienced the imposition of significant penalties for violating the commission’s capacity release policies: for example, *Puget Sound Energy* ($800,000 civil penalty) and *Anadarko Petroleum Corp.* ($1.1 million civil penalty and $232,423 disgorgement).

**SHIPPER MUST HAVE TITLE TO GAS**

FERC has also established a firm policy that requires each shipper on an interstate pipeline to have title to the gas that it ships. In Enron Energy Services, Inc. and Enron Capital Trade Resources
Enron sought a limited waiver of this commission policy. Enron’s request was based on allegations that compliance with the commission’s policy was subjecting Enron to New York taxes, creating a competitive disadvantage for gas being supplied under such transactions. In rejecting Enron’s requested waiver, the commission reiterated its policy concerning the requirement that the shipper must have title, stating the following:

The Commission articulated its shipper must have title policy in proceedings involving the implementation of open access transportation under Order No. 436 stating that “all shippers shall have title to the gas at the time the gas is delivered to the transporter and while it is being transported by the transporter.” This policy was not changed under Order No. 636 or by the Commission’s capacity release rules, and remains in effect (Ibid., at 62,062).

More recent cases demonstrate that the commission is committed to enforcing the shipper must-have-title requirement. For example, in an action brought by FERC’s Enforcement Office in 2007, Bangor Gas Company, LLC, was found to have violated the shipper must-have-title requirement by transporting its own gas on interstate pipelines using transportation capacity held by some of its transportation-only customers. Although the commission noted that Bangor “did not profit from its violations” and “no identifiable financial harm to third parties was caused by Bangor’s violations,” a civil penalty of $1 million was imposed on Bangor.

Similar violations have come to light involving Calpine Energy Services LP ($400,000 civil penalty); BP Energy Company; Constellation NewEnergy—Gas Division, LLC; Sempra Energy Trading, LLC ($400,000 civil penalty); DCP Midstream, LLC ($360,000 civil penalty); ONEOK, Inc. ($4.5 million civil penalty and $1.9 million disgorgement); and Tenaska Marketing Ventures ($3 million civil penalty and $2 million disgorgement).

While some pipeline tariffs have incorporated language that would only require a shipper to demonstrate that it “has a right to ship,” following such language did not protect National Fuel Marketing (NFM) in a recent FERC enforcement action concerning bids submitted for capacity in a Cheyenne Plains Gas Pipeline Open Season. As evidenced by the views expressed by Commissioner Moeller in that proceeding, sometimes the clarity of what FERC expects in the conduct of market participants comes after the fact via an expensive and costly enforcement action.

SUMMARY

Compliance with FERC’s policies relating to the release and transfer of capacity on interstate pipelines should not be overlooked or disregarded. The commission is committed to ensuring that markets for interstate pipeline capacity are open to all shippers and that shippers who value pipeline capacity the most will have full opportunity to contract for such capacity.

Under the Energy Policy Act of 2005, FERC’s civil penalty authority for violations of the Natural Gas Act was increased to $1 million per violation for each day the violation continues. Thus, in the current regulatory environment, seeking permission from FERC prior to undertaking a transaction involving tied agreements (through a thoughtfully written petition) is a more economical approach than seeking forgiveness, which may be viewed by FERC’s Enforcement Office as contravening FERC’s policies. Noncompliance with any of the commission’s capacity release-related policies can be a costly mistake.

NOTES

2. 111 FERC ¶ 61,509 (2005).
4. For example, in Texas Eastern Transmission LP, 121 FERC ¶ 61,299 (2007), the commission approved the direct assignment of two firm discounted backhaul service agreements that had been held by Entergy Gulf States, Inc. where the assignments were being made to an affiliated entity, Entergy Gulf States Louisiana, to implement a jurisdictional separation plan that had been approved by the commission under the Federal Power Act for Entergy.
9. 18 C.F.R. § 284.8.
11. 84 FERC ¶ 61,222 (1998).