Natural Gas Regulation and Unbundling in the United States

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Evolution of the Natural Gas Industry

Era of Development: 1910 - 1950

Era of Regulation: 1950 - 1970’s

Era of Market Inefficiency: late 1970’s - mid 1980’s

Era of Adjustment/Restructuring/Deregulation:
late 1980’s - 2000

Federal/State Jurisdiction Over Natural Gas Industry

- Federal rules are primary
- Any area not preempted by Federal jurisdiction can be regulated by states
- State jurisdiction can be joint with federal
- State jurisdiction can be more restrictive than federal when minimum standards are set but not more restrictive when maximum standards are set

Federal Energy Regulatory Commission (FERC)

- Independent regulatory agency that regulates aspects of the electric, natural gas and oil pipeline and nonfederal hydropower industries
- Created through the Department of Energy Organization Act on October 1, 1977
- Ensures that rates, terms and conditions of service are just and reasonable
- Authorizes construction of natural gas pipeline facilities
- Ensures hydropower licensing, administration and safety actions are consistent with the public interest
- Five Commissioners appointed by the President with consent of the Senate to serve five-year terms

Key Federal Decisions/Regulation of the Gas Industry

- Natural Gas Act of 1938: regulation of interstate pipelines
- Supreme Court Decisions (Phillips, 1954): Interstate Gas
- Natural Gas Policy Act of 1978: Response to curtailments in mid 1970's
- FERC Orders 436, 500, 636 (1985 - 1993)
  - restructured interstate market
- Natural Gas Wellhead Decontrol Act
  - decontrol of wellhead prices

Phillips Decision - 1954

- Concluded that independent producers selling gas into the interstate market were subject to federal jurisdiction under the Natural Gas Act
- Placed gas production destined for the interstate market under Federal Power Commission jurisdiction
- Applied traditional cost-of-service ratemaking to the cost of gas charged by producers to pipelines

Natural Gas Policy Act of 1978

- Jurisdiction rested in Federal Energy Regulatory Commission (FERC) as successor to the Federal Power Commission (FPC)
- Created a single national gas market
- Promoted alignment of supply with demand
- Allowed for wellhead gas prices to be established by market forces
- Created new statutory rates for the wholesale gas market, in lieu of rates established by the FPC/FERC

Era of Adjustment/Restructuring/ Deregulation: late 1980's - 2000

- Period of transition - policy and market changes
- Wellhead prices deregulated - spot, futures markets develop
- Restructured transmission industry - emergence of marketers
- Market centers, hubs, storage expansion
- Retail Market regulatory changes

FERC Order 436 (1985)

- Permitted pipelines to obtain blanket certificates that permitted transportation without prior FERC approval
- Required open-access transportation
- Permitted pipelines to discount transportation rates

FERC Order 500 (1987)

- Required producers utilizing open-access transportation on pipelines to give take-or-pay credit for volumes transported
- Established take-or-pay buyout and buydown policy
  - buyout and buydown costs could be passed through via a commodity surcharge, a direct bill, or a combination of the two

FERC Order 528 (1989)

- Changed only the mechanism for billing pipeline customers for these costs
- Urged pipelines and their customers to settle buyout arrangements
- Almost all pipelines reached settlements with their customers

Natural Gas Wellhead Decontrol Act of 1989

- Amended Natural Gas Policy Act (NGPA)
  - repealed all remaining price controls on wellhead or field sales of natural gas
- Decontrolled the first sale of natural gas, but did not deregulate interstate natural gas pipelines

FERC Order 636 (1992)

Required merchant and transportation functions of pipeline to be totally separated and on a "comparable" basis

- Total unbundling of the sales and transportation functions in the sale of gas
- Permitted pipelines to compete freely as gas merchants
- FERC no longer established a fixed, cost-based rate for pipeline sale of gas to customers
- Provided for transition costs
  - permitted pipelines to pass on 100 percent of the costs of compliance to their customers
- Permitted pipeline customers to resell their unused pipeline transportation capacity in a secondary market by means of capacity release
- Required all pipelines to adopt a uniform straight fixed-variable (SFV) rate design
- Required pipelines to implement Electronic Bulletin Boards (EBB's)
- Required each pipeline to make compliance filings

FERC Order 637 (2000)

Restructuring of Pipeline Services

- Removed price cap on short-term capacity releases
- Encouraged differentiated peak and off-peak rates
- Encouraged pipelines to seek term-differentiated rates
- Required scheduling equality between primary pipeline services and secondary market transactions
- Required segmentation of primary and secondary services to the extent operationally possible
- Required parking and lending services as a way to avoid imbalances
- Altered policies on penalties and operational flow orders so that they are imposed only when necessary to protect system integrity

Current Issues Before FERC

- Order 637 Compliance Proceedings
- Order 637 Dialogue Issues
  - Is the Market Liquid?
  - Is There a Need to Revamp Affiliate Rules?
  - Another dialogue session?
- Adequacy of Infrastructure
- Reliability of Interstate Pipeline Service
- California Gas Issues
  - Order 637 price cap waiver
  - Transportation contracts into California
  - Price reporting of sales and capacity into California

Jurisdiction Over Natural Gas Pipeline & Distribution Companies

- State
  - Regulates intrastate pipeline companies
  - Regulates local utility rates, certain operations, siting, construction, emissions
- Federal
  - Federal Energy Regulatory Commission (FERC) regulates interstate pipeline rates, construction and certain operations
  - U.S. Department of Transportation - pipeline safety, inspections
  - Environmental Protection Agency- environmental regulations, emissions, ground water impact
- Local Jurisdiction
  - Regulate municipal utilities rates and operations

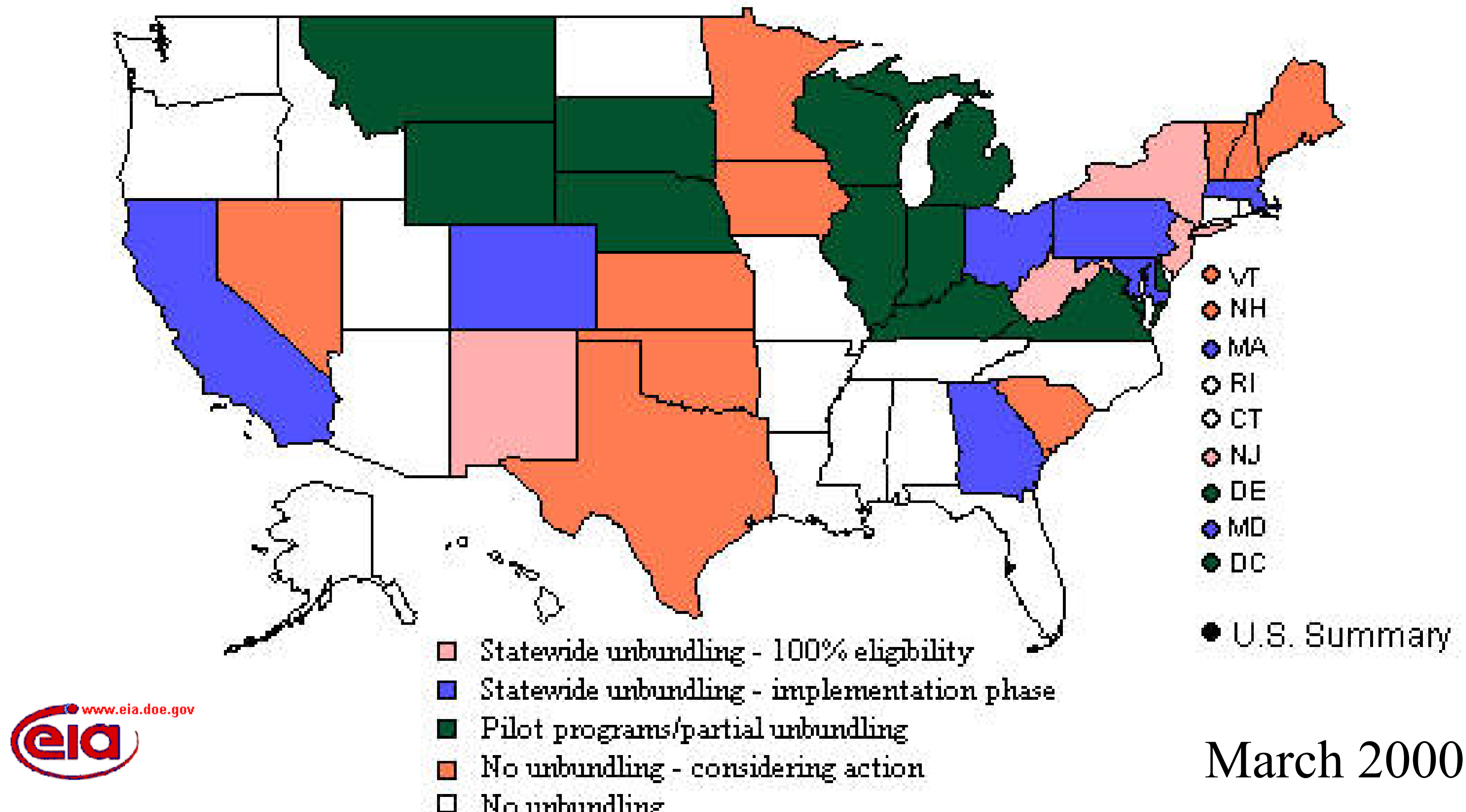
Role of Connecticut Department of Public Utility Control

- Register Suppliers/Marketers
- Inspection of Interstate Pipeline Facilities in Connecticut
- Direct jurisdiction over Intrastate Gas Facilities
  - more stringent than federal minimums

Developments in Natural Gas Retail Markets

- Many states are promoting residential consumer choice
- More than half of the states have residential choice programs
- States are taking different approaches

Status of Natural Gas Residential Choice Programs in the US



Questions?