

THE AGA FERC MANUAL: A Guide for Local Distribution Companies

2013 EDITION

Prepared by Van Ness Feldman, LLP for the American Gas Association

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THE AMERICAN GAS ASSOCIATION FERC MANUAL: A GUIDE FOR LOCAL DISTRIBUTION COMPANIES—2013 EDITION

PREPARED BY VAN NESS FELDMAN, LLP FOR THE AMERICAN GAS ASSOCIATION

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Please forward any comments or suggested edits regarding this publication to: Michael L. Murray, Deputy General Counsel, American Gas Association, 400 N. Capitol Street, NW, Washington, D.C. 20001, mmurray@aga.org.

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1. Van Ness Feldman, LLP is referred to throughout as “Van Ness Feldman.”

DEDICATION

This edition of the *AGA FERC Manual* is dedicated to the people of Van Ness Feldman. Their prodigious contribution to the jurisprudence of our industry is matched by their kindness and generosity.

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As was the case with the original *FERC Manual*, the AGA sought the assistance of Lawrence G. Acker for the preparation of 2013 Edition of the *FERC Manual*. Mr. Acker has substantial experience in practice before the Federal Energy Regulatory Commission and is Of Counsel to Van Ness Feldman. He has been the principal author and editor of the *FERC Manual* since the first edition.

The lawyers who contributed to the original edition are identified in a note at the beginning of each chapter. Lawyers and energy analysts who have contributed to the current edition, including by reviewing and, where necessary, updating materials, are identified in the heading of the chapters to which they contributed in the current edition. The current contributors consist of lawyers and senior energy analysts at Van Ness Feldman and Elizabeth W. Powers of Duane Morris LLP.

Information about Van Ness Feldman, its lawyers and its senior energy analysts may be found at www.vnf.com. Information about Ms. Powers can be found at <http://www.duanemorris.com/attorneys/elizabethwpowers.html>.

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The American Gas Association extends its thanks to all of the contributors.

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INTRODUCTION TO THE 2013 EDITION

WHAT'S IN THE *FERC Manual*, 2013 Edition?

From the inception of the *FERC Manual*, the AGA, the Sponsoring Members of the *FERC Manual*, and the Legal and Federal Energy Regulatory Commission (“FERC”) Regulatory Committees, anticipated that as FERC’s requirements and restrictions changed, some of the substance covered by each edition would need to be updated to keep it current. Their foresight continues to be borne out by experience.

The 2013 Edition of the *FERC Manual* retains the essential structure and content of the original edition, but has been updated to take into account developments in a variety of areas or, in some instances, expanded to include coverage of a subject that was not included in earlier editions. The new subjects encompass:

- The evolution of FERC’s consideration of pipeline tariff provisions dealing with service interruptions;
- FERC’s rate treatment of expenses and investments made in light of pipeline safety legislation and evolving environmental standards;
- Limitations on pipeline market-based storage rates;
- How waivers of Capacity Release Rules for restructuring transactions have evolved from the extraordinary to the routine;
- Decisions of FERC and reviewing courts in litigated and settled cases considering market manipulation, including new restrictions on the scope of FERC’s jurisdiction; and
- Cautionary notes about FERC and Commodity Futures Trading Commission (“CFTC”) authority.

As has been the practice with earlier editions of the *FERC Manual*, this edition includes updated and new hypotheticals and accompanying explanatory material.

FERC’s regulations exert a significant influence over Local Distribution Companies (“LDCs”) and other users of pipeline services, as well as intrastate and Hinshaw pipelines. This is despite the fact that these entities generally lie outside of FERC’s jurisdiction under the Natural Gas Act (“NGA”) or operate under grants of authority exposing them only to the most limited exercise of FERC jurisdiction.

The engagement of FERC in their businesses makes it advisable for these companies to have at hand a readily usable and current source of information about FERC’s rules, requirements, and restrictions.

The 2013 Edition of the *FERC Manual* includes updated text, sidebars, charts and tables, and new hypotheticals about FERC developments. Its contents reflect suggestions from the *FERC Manual's* Sponsoring Members, the AGA Legal Committee, and the FERC Regulatory Committee for new subjects.

INTRODUCTION

WHY THE *FERC MANUAL* IS NEEDED

FERC's authority once was focused on reviews of pipeline tariffs to ensure they contained just and reasonable terms, conditions, and rates. That focus has changed substantially. Although FERC now routinely reviews rates, as well as select terms and conditions of a handful of pipelines and storage companies each year, FERC considers its primary goals to encourage fair and efficient competitive markets, to prevent the accumulation and exercise of market power, and to prevent market manipulation.

FERC fostered the development of open natural gas markets for almost two decades, but the Energy Policy Act of 2005 ("EPAAct 2005") marked the first time Congress created a statutory tool to protect the integrity of natural gas markets. EPAAct 2005 established:

- Statutory responsibility for ensuring against manipulation by any entity of the markets subject to NGA jurisdiction; and
- Substantial penalty authority for violations of a statute, rule, regulation, or order within the scope of NGA jurisdiction (in a nutshell, penalties of up to \$1 million per violation for each day the violation continued).

Users of pipeline services, in general, and LDCs in particular, have been the subject of a large number of FERC enforcement settlements since EPAAct 2005 became law. These settlements have focused on interstate transportation and sale of gas by LDCs, the relationship of an LDC with its affiliated interstate pipeline (e.g., standards of conduct rules), and LDCs as shippers on interstate pipelines (e.g., obtaining capacity directly from the pipeline as well as Capacity Release Rules, the use of asset management arrangements and the Shipper Must Have Title requirement).

In light of the focus of FERC's enforcement activities, the AGA and its Legal and FERC Regulatory Committee consider that the *FERC Manual* can serve a useful purpose for the AGA's members and others. The AGA, and the Legal and FERC Regulatory Committees hope that the *FERC Manual* will be one of the first places to which users of pipeline services turn for quick answers about FERC's rules, more detailed explanations and for guides to additional research.

A GUIDE TO THE *FERC MANUAL*

The *FERC Manual* is focused on FERC's regulation of companies under the NGA and the Natural Gas Policy Act of 1978 as that regulation affects LDCs and other users of pipeline services. The *FERC Manual* is not intended to be a treatise on the subjects it covers and it is not legal advice. Rather, the *FERC Manual* is intended to be a practical tool for day-to-day use, while also containing substantial explanatory material about the logic and background of FERC's rules.

The *FERC Manual* includes as Chapter 1 a brief history of FERC's natural gas regulation; Chapters 2 through 8 cover the following operational headings: Services of Pipelines and Storage Companies; Rules Relating to LDCs as Shippers or Storage Customers: Obtaining Capacity Directly from the Pipeline and Obtaining Capacity from Other Shippers; FERC's Regulation of LDCs as Natural Gas Sellers; LDCs as Transportation and Storage Service Providers; Other Substantive Aspects of Regulation by FERC Affecting LDCs; and FERC's Rules About Market Manipulation. Chapters 9 and 10 deal with Enforcement and with Compliance Plans, respectively.

The Table of Contents is a critical gateway to the *FERC Manual*. The user engaged in a particular transaction or needing an answer to a particular question will find within the broad chapter categories, subchapter headings that will lead directly to the subject of interest.

The reader who is interested only in a very short statement of a major rule, a definition, a restriction or a requirement without explanation will find it in the highlighted sidebars that appear in every chapter.

The highlighted sidebars are accompanied by detailed explanatory text, as well as hypotheticals that include additional explanations. The detailed text outlines the development and logic of the governing rules. The explanatory material has been provided in small doses to encourage even the reader only interested in the short explanation to go further without slowing down very much. The reader also will find citations to regulations and cases which the authors consider to be a good place to start research on a specific issue—even though the *FERC Manual* is not designed to be encyclopedic in its treatment of the subjects discussed.

Finally, some of the chapters also include checklists and summary tables. These are not intended to be iron-clad or unvarying statements. They are intended to illustrate an organized thought process that can be adapted to particular situations. Because most transactions have distinct features, checklists should be structured to match individual transactions.

The *FERC Manual* is intended to be of particular value when an LDC uses the services of a pipeline or a storage company (e.g., as a shipper that obtains capacity or contracts for services); when an LDC provides FERC-jurisdictional services (e.g., as a transporter or to release capacity); if an LDC releases or obtains capacity (directly from a pipeline or from a releasing shipper); or when an LDC acts as a buyer or seller of gas.¹ These activities engage FERC's authority.

1. In this latter regard, and as a cautionary note, FERC does not exercise exclusive authority in connection with the effect of sales of gas on markets. Rather, FERC asserts that its authority overlaps with but is independent of authority of the CFTC under the Commodity Exchange Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act to prevent manipulation and disruption in the futures, derivatives, and physical markets. The latter subject is beyond the scope of this *FERC Manual*, but the reader should not overlook that authority. See Section 5.5.1 for more detail.

The *FERC Manual* includes definitions of commonly used terms and a glossary of acronyms used widely throughout its pages. It also includes an Appendix with formal citations to cases and orders to which the text frequently refers, while the text uses short-form citations to minimize interruptions to the flow of reading.

Associated with the *FERC Manual* is a series of video recordings of seminars conducted by Van Ness Feldman lawyers on the major subjects in the *FERC Manual*. The seminars are quite detailed and are updated to reflect new developments. The videos offer the viewer the option of watching the entire video at once or using chapter links to view specific sections.

THE AMERICAN GAS ASSOCIATION

The American Gas Association, founded in 1918, represents more than 200 local energy companies that deliver clean natural gas throughout the United States. There are more than 71 million residential, commercial and industrial natural gas customers in the United States, of which 92 percent—more than 65 million customers—receive their gas from AGA members. Today, natural gas meets almost one-fourth of the United States' energy needs.

AGA's vision is to provide clear value to its membership and serves as the indispensable voice, and facilitator, on its behalf in promoting the safe, reliable and cost-effective delivery of natural gas to the more than 65 million customers in the American homes and businesses that the AGA membership serves.

The AGA represents companies delivering natural gas to customers to help meet their energy needs. AGA members are committed to delivering natural gas safely, reliably, cost-effectively and in an environmentally responsible way. AGA advocates the interests of its members and their customers, and provides information and services promoting efficient demand and supply growth, and operational excellence, in the safe, reliable and efficient delivery of natural gas.

The AGA Legal Committee consists of members from a cross section of member companies—generally the chief legal officers of the companies. The Legal Committee helps to shape government policy, increase members' success in advocacy, keeps the members abreast of legal developments, and sharpens the companies' attorneys' skills. The Legal Committee helps to formulate legal policies for the AGA; provides legal advice to the AGA Board of Directors; guidance to AGA on litigation (federal and state); and support to members in potentially precedent-setting cases. The committee also sponsors the annual AGA Legal Forum, the preeminent legal programs for attorneys in the natural gas industry. The Legal Forum is an intensive two-day seminar that gives participants the opportunity for in-depth discussion of gas industry issues. Continuing legal education credit for attorneys is provided in this and other legal programs.

The AGA FERC Regulatory Committee reports to the AGA Government Relations Policy Committee (“GRPC”). It implements the policy priorities of the GRPC with regard to matters pending before FERC, including the formulation of responses to regulatory initiatives. The committee provides both policy and technical guidance regarding the AGA’s position on rulemakings, policy statements and hearings conducted by FERC, and on appellate review of those matters. The committee seeks to advocate to FERC consensus positions representing LDC interests before FERC. Its objectives are to advocate successfully policies at FERC that will maintain high quality pipeline service to LDCs, that will protect and enhance the value of transmission capacity held by LDCs, to promote the development of infrastructure, particularly for delivering new natural gas supplies to market, and to increase understanding by FERC Commissioners and Staff of the commercial and operational context for LDCs. The committee is comprised of general counsels and assistant general counsels, vice-presidents, directors and managers of gas supply, planning and regulatory affairs of AGA member companies whose job duties are affected by FERC regulations and activities.

The American Gas Association is located at 400 North Capitol Street, NW, Suite 450, Washington D.C. 20001. Please visit their web site at www.aga.org.

VAN NESS FELDMAN, LLP

Van Ness Feldman was founded in 1977 by former Congressional and Executive branch staff and has offices in Washington D.C. and Seattle, Washington. Van Ness Feldman provides strategic business advice, legislative and policy advocacy, legal and regulatory compliance counsel, representation in administrative proceedings and litigation, and support for project development, permitting, and transactions in the inter-related areas of energy, the environment, natural resources, public lands, real estate, health care, land use, and infrastructure.

Van Ness Feldman has a diverse range of clients including leading LDCs, electric utilities, natural gas and oil production and pipeline interests, renewable energy project developers, manufacturing and industrial concerns, financial institutions and investment funds, clean technology companies, health care services companies, federal lands concessioners, municipalities, trade associations, and coalitions. These clients rely on the firm’s professionals for their substantive expertise and their practical, collaborative approach to complex, cutting-edge issues.

A large component of Van Ness Feldman’s practice involves “day-to-day” counseling and advice, as well as representation before FERC, on regulations and policies regarding the construction and operation of infrastructure projects, trading, and marketing operations. The firm assists clients in developing effective regulatory compliance and risk assessment strategies, and in responding to enforcement actions, investigations, and audits. Van Ness Feldman represents clients on issues

such as standards of conduct, affiliate transactions, and compliance with the North American Electric Reliability Corporation reliability standards. The firm also provides transactional and regulatory counsel in corporate mergers, acquisitions and reorganizations, as well as energy asset acquisitions and sales.

Van Ness Feldman's website can be found at www.vnf.com.

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AN OVERVIEW OF THE HISTORY OF FERC'S REGULATION OF NATURAL GAS

AUTHOR OF THE ORIGINAL AND CURRENT EDITION:¹ LAWRENCE G. ACKER

Before turning to a detailed exploration of how regulation by the Federal Energy Regulatory Commission ("FERC") affects Local Distribution Company ("LDC") operations today, a very brief description of the agency and the history of natural gas regulation will provide a useful context.

1.1 FERC

FERC is an independent regulatory agency within the U.S. Department of Energy ("DOE") whose statutory authority centers on major aspects of the Nation's wholesale electric, natural gas, hydroelectric, and oil pipeline industries. FERC was created by the Department of Energy Organization Act on October 1, 1977 ("DOE Organization Act"). At that time, the Federal Power Commission ("FPC"), FERC's predecessor agency that was established in 1920, was abolished and FERC succeeded to most of the FPC's regulatory functions.

Although the FPC's enabling and implementing legislation for natural gas matters was the NGA, FERC's enabling legislation is the DOE Organization Act and not the NGA. The DOE Organization Act does not transfer to FERC authority over all of the provisions of the NGA. Rather, FERC was given authority over specific provisions, permitted to exercise the functions of other specific provisions as needed to implement its authority, and the remaining provisions were transferred to the Secretary of Energy.

FERC consists of up to five commissioners each of whom is appointed by the President with the advice and consent of the Senate. Commissioners serve staggered five-year terms and each has an equal vote on regulatory matters. No more than three commissioners may belong to the same political party. One member of FERC is designated by the President to serve as Chair and FERC's administrative head. FERC is a collegial body that speaks through its written orders. In some instances, FERC's orders delegate limited authority to members of its Staff.

1.2 INITIAL SCOPE OF JURISDICTION

Before the advent of high-pressure pipelines in the 1920s, natural gas ordinarily was flared off in the field where it was produced or sold for local use. The development of high-pressure pipelines led to new intrastate and interstate markets for sales of natural gas. The interstate transportation and wholesale prices of natural gas (like the interstate sale and transmission of electricity) were not subject to government

FERC is an independent regulatory agency that was created as the successor to many of the functions of the Federal Power Commission. Its statutory authority centers on major aspects of the Nation's wholesale electric, natural gas, hydroelectric, and oil pipeline industries.

Until 2005, FERC's natural gas jurisdiction was limited to regulating the transportation and sale for resale of natural gas in interstate commerce. Since passage of the Energy Policy Act of 2005, FERC has acted to ensure the fairness of natural gas markets and to enforce that authority with multi-million dollar penalties.

1. Ahren S. Tryon contributed to this Chapter in the Original Edition of the AGA FERC Manual.