UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Dialog Concerning Natural Gas Transportation	)	
Policies Needed to Facilitate Development of	)	Docket No. PL00-1-000
Competitive Natural Gas Markets	)	

INITIAL POST-TECHNICAL CONFERENCE COMMENTS OF THE NATURAL GAS SUPPLY ASSOCIATION

Pursuant to the procedures established in the Notice of Staff Conference issued in the above-captioned docket on November 22, 2000, the Natural Gas Supply Association ("NGSA") submits its initial post-technical conference comments. These comments relate to the March 15, 2001 "roundtable discussion" conducted by the staff of the Federal Energy Regulatory Commission ("Commission") and industry representatives.

I. COMMUNICATIONS AND CORRESPONDENCE.

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II. INTRODUCTION.

The focus of the March 15 conference was "whether the regulatory policy with respect to pipeline affiliates and non-affiliates, as well as asset managers and agents, should be revised to reflect the changing nature of the gas market" and "whether there need[] to be revisions to the regulations relating to pipeline affiliates."[1] As might be

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[1] November 22, 2000 Notice, slip op. at 1, quoting *Regulation of Short-Term Natural Gas Transportation Services*, Order No. 637, Final Rule, FERC Stats. & Regs., Regs. Preambles [Jan. 2000-June 2000] ¶

expected, the views of industry participants varied widely. NGSA, Dynegy, the Independent Petroleum Association of America ("IPAA"), and the California Dairy Counsel argued strongly in favor of revising existing rules governing pipeline affiliate marketers to take into account changes in the natural gas industry and new opportunities for affiliate preference. The Interstate Natural Gas Association of America ("INGAA") and an ad hoc group of pipeline affiliate marketers took a diametrically opposed view, arguing that existing rules need not be revised.

Those who oppose reform of the Commission's regulation of pipeline affiliates base their arguments on five core propositions:

1. Pipeline affiliate activity is largely unchanged since issuance of Order No. 497.
2. No new market risks exist with respect to pipeline affiliate activities relating to electric generation.
3. Pipeline marketing affiliates are now "separate business units" capable of dealing at arm's length with affiliated pipelines.
4. Reporting requirements are now so sophisticated and transparent that any suspect affiliate activity can readily be exposed. Injured parties can then "just file a complaint."
5. There is no "evidence" of any substantial pattern of affiliate abuse since Order No. 497 was issued.

Each of these propositions is incorrect, for the reasons outlined in detail below. None of these arguments justify turning a blind eye to the new and enhanced risks to competition posed by pipeline affiliate marketers. Now is the time for meaningful regulatory reform.

As NGSA argued in its initial comments in this proceeding (filed on January 5, 2001), current reporting requirements are not adequate to prevent or curtail pipeline/affiliate dealings that may injure the development of competitive markets. At a bare minimum, the reporting requirements adopted in Order No. 637 must be enhanced

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31,091, at 31,268-69 (February 9, 2000); Order No. 637-A, *Order on Rehearing*, FERC Stats. & Regs. ¶ 31,099 (May 19, 2000).

so that industry participants can analyze reported data in a user-friendly, standardized format. Pipelines should be required to report actual usage and non-usage of scheduled capacity. Where an affiliate holds a large share of pipeline capacity, additional data should be required. In addition, bidding procedures should be revised and rate caps for capacity released by a marketing affiliate should be restored.

Reporting requirements must be supplemented by an effective market monitoring program under the aegis of the Commission. The Commission should revisit the scope of the definition of marketing affiliate. The definition of "marketing affiliate" should be expanded to cover all entities that hold or manage interstate pipeline capacity and that also have a corporate affiliation with the pipeline, including but not limited to affiliated asset managers and electric affiliates. This does not imply, however, that affiliates cannot do business on their "home" pipelines. Expansion of the affiliate rules simply requires separation of facilities and reasonable safeguards to ensure that commercially sensitive third party information is not shared. Finally, if violations are discovered that are found to be egregious by the Commission, the Commission should consider structural separation (*i.e.,* divorcement) as a regulatory "last resort" to prevent affiliate abuse.

III. ARGUMENT.

A. The Resistance to Reform Is Based on Flawed Premises Regarding the Current Structure of the Natural Gas Industry.

As noted above, during the March 15 conference, those who oppose reform of the Commission's regulations governing pipeline affiliate marketers base their arguments on the five core premises cited above.

Each of these objections does not withstand scrutiny.

1. Since the inception of Order No. 497, the size, scope and competitive impact of pipeline affiliate activities has expanded radically.

During the public conference, INGAA submitted a chart purporting to compare "Marketing Affiliate, Other Affiliate and Total Affiliate Share of Primary Capacity on Major Interstate Pipelines, 2000 and 1996." INGAA claimed, based on this data, that pipeline affiliate capacity holdings largely were unchanged. The total average capacity held decreased from 14.7% in 1996 to 14.4% in 2000. The apparent inference INGAA wishes to create is that little if anything has changed in the past four years that would warrant any changes to the Commission's regulations governing pipeline affiliates.

INGAA's analysis of pipeline capacity holdings is flawed. First, the two data sets upon which INGAA's analysis is based do not contain any information on contracts under which a pipeline affiliate functions as the shipper's agent. This information simply did not appear in either the 1996 or the 2000 Index of Customers.[2] Nor does INGAA's analysis take into account a pipeline marketing affiliate's control of strategic assets, such as storage, or critical transportation paths. Both omissions are material and significant.

INGAA's analysis indicates that on Southern Natural Gas Company, pipeline marketing affiliates hold 0.1% of capacity. Other affiliates are said to hold only 4.3% of capacity, suggesting that affiliate transactions are not relevant. However, based on a review of the January 2001 Index of Customers for Southern, Southern's marketing affiliate El Paso Merchant Energy controls, as an asset manager, 27% of Southern's Rate Schedule CSS (contract storage capacity).

Florida Gas Transmission presents a similar situation. The October 2000 Index of Customers indicates that the total capacity held by pipeline marketing affiliates is

[2] Information regarding the identity of asset managers was required to be included in quarterly Index of Customers filings effective October 2000.

comparatively low (around 3.4%). Up to 34.9% of the capacity on the system appears to be managed by affiliated agents, however.

INGAA's chart is not only inaccurate. It is misleading. It cannot credibly be maintained that the competitive significance of interstate pipeline marketing affiliates has remained largely unchanged since 1996. The natural gas pipeline industry has consolidated. Two pipeline holding companies, El Paso and Williams, now control about 16 of the nation's interstate pipelines, including some of the largest. Convergence mergers have become the order of the day, from the Koch-Entergy merger to the CMS acquisition of Panhandle, Trunkline and Sea Robin, to the Dominion acquisition of CNG. As discussed below, gas-fired generation has become a critical focus of the business plans of many pipeline affiliates.

During this wave of mergers, the money-making capabilities of pipeline affiliate marketers considerably have improved. Independent marketers, with rare exceptions, have either been swept up by merger activity or swept away.

During the March 15 conference, several opponents of reform requested that "proof" be submitted that the trends noted above have had an impact on the competitive position of pipeline affiliate marketers. This is a fair request, and one that easily is met.

In 1993, The Williams Companies organized their natural gas marketing activities under Williams Field Services Group, Inc. According to Williams' 1993 Form 10-K filed with the SEC, 89% of the operating profit of the Williams Field Services Group consisted of gathering and processing activities, with marketing and production activities making up the balance. The Williams Companies, Inc. 1993 Form 10-K, at 9. The total reported operating profit for 1993 for Williams Field Services Group, Inc. was $125.5

million. The Williams Companies, Inc. 1993 Form 10-K, at F-8. It would therefore appear that the total operating profit associated with Williams Field Service Group, Inc.'s natural gas production and marketing activities in 1993 was $13.8 million (11% of $125.5 million).

In 2000, Williams Energy Marketing & Trading reported average marketing and trading physical volumes of natural gas of 3.3 billion cubic feet per day, and 141,311 million megawatt hours of power. Williams Energy Marketing & Trading's reported segment profit for 2000 was $1,007.9 million, up $903.9 million from 1999. The Williams Companies, Inc. 2000 Form 10-K, at 21 and 42.

In 1993, El Paso did not separately report the operating profit of its marketing division. However, by 2000, the reported earnings before interest and taxes (excluding non-recurring items and including the impact of the El Paso-Coastal merger) was said to be $960 million (up from $329 million in 1999). El Paso Energy, Annual Report to Shareholders, at 10.

In the first full year after acquiring Panhandle and Trunkline, CMS Energy reported that its revenue associated with marketing, services and trading had increased 236.5% (from $1,320 million to $4,442 million). CMS Annual Report to Shareholders (2000), at 3.

According to Entergy, the Entergy-Koch joint venture will trade volumes in excess of 100 million MWH of electricity annually and 5 Bcf of gas a day. Entergy Annual Report to Shareholders (2000), at 15.

The simple fact is that pipeline marketing affiliates have grown in power and competitive impact since Order No. 497 was released.[3] They have been transformed in many cases from incidental niche players to dominant competitors. The synergies associated with their pipeline affiliations have, in many cases, been a key driver of growth. Marketing activities now rival or exceed revenues from regulated lines of business.

2. New Gas Fired Electric Generation Presents New Opportunities for Affiliate Abuse.

During the March 15 conference, INGAA presented a second chart, representing (based on July 2000 Index of Customer data) that "generation affiliates" controlled only 0.2% of contracted capacity on affiliated pipelines. Once again, the apparent conclusion INGAA would draw is that concerns regarding the opportunities for anticompetitive conduct between interstate natural gas pipelines and affiliated marketers with respect to new electric generation were at best misplaced.

INGAA's study and its conclusion are both flawed. The Index of Customers report does not require the identification of affiliated end-use customers (such as generation affiliates) if they are not shippers of record on a pipeline. If an affiliated generator takes service through an LDC delivery point, the affiliated generator will not "show up" on the Index of Customers. If an affiliated generator purchases service under an interruptible rate schedule, its service will not appear on the Index of Customers. Generation affiliates need not be shippers of record to be provided an undue preference or

[3] Paradoxically, this expansion to some extent has been financed by pipeline customers, including competing marketers. Many interstate pipelines still have in effect stale rates, in which corporate overhead costs have been allocated among affiliated companies based on the size (both in terms of employees and revenues) of their marketing affiliates in the early to mid 1990's. Based on the data outlined above, for many pipelines setting current just and reasonable rates would entail a major shift in corporate overhead costs away from regulated lines of business.

competitive advantage by an affiliated pipeline. INGAA's study simply demonstrates that information that is not required to be reported is not reported.

For example, the INGAA study indicates that the generation affiliate share of primary capacity for GulfSouth Pipeline Company is 0%. This is both accurate and irrelevant. GulfSouth has 19 power plants directly connected to its system. Nine of the largest are affiliated with GulfSouth (through Entergy). All take service under **interruptible** rate schedules. Affidavit of Charles J. Cicchetti, Entergy Power Marketing Corp., Docket No. EC00-106-000, at 30-31.

The natural gas industry reasonably anticipates an increase in demand based on new gas-fired generation. Pipelines and pipeline marketing affiliates have adjusted their business plans around this projected market growth, and many new services are being designed to meet specific generation needs. Williams states that "[b]eginning in 2000, EM&T's natural gas marketing operations focused on activities that facilitate and/or complement the group's power portfolio."[4] CMS Energy similarly states that it plans to expand the business opportunities of Panhandle Eastern Pipeline in part through connection of new gas-fired generation.[5] The convergence of pipeline affiliate marketing activities into both natural gas and electric wholesale markets, coupled with the market power exercised by affiliated pipelines and affiliated electric transmission and distribution companies, presents new risks of anticompetitive conduct based on a new market reality that the Commission cannot simply ignore.

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[4] Williams 2000 SEC Form 10-K, at 20.
[5] CMS Energy 2000 SEC Form 10-K, at CMS-15 to CMS-16.

3. <u>Natural Gas Pipelines and Marketing Affiliates Have No Incentive to Deal at Arm's Length</u>.

The Ad Hoc Marketers Group of Pipeline Marketing Affiliates maintains that pipelines and their marketing affiliates effectively can deal at arm's length because they are separate business units, judged solely on the results of their own divisions.

This argument is at best misguided. Shareholders evaluate corporate performance based on corporate returns. A marketing affiliate that adopts a long-term strategy of profiting at the expense of an affiliated pipeline adds little or nothing to the bottom line. To suggest that a pipeline and its marketing affiliate are not both responsible to maximize the corporate good is either reflective of utterly disjointed management oversight or represents a totally unreal perspective on internal corporate relationships. The explosive growth of pipeline affiliate marketing companies affiliated with the two largest pipeline holding companies in America is not simply a happy accident, but reflects the ability of the pipeline affiliate marketer to capitalize on opportunities, including the structural advantages inherent in its affiliation with one or more interstate pipelines. This is all **smart** business strategy, particularly when affiliate preference or competitive advantages are not barred by current rules.

The Commission and the federal courts have recognized the special risks associated with affiliate relationships in cases arising under both the NGA and the Federal Power Act.[6] In its decision affirming Order Nos. 497 and 497-A, the United States Court of Appeals for the District of Columbia Circuit recognized: "The record clearly contains evidence supporting FERC's conclusion that pipelines, which have

[6] In administering parallel provisions of the Federal Power Act the Commission has required the formation of regional transmission organizations to administer electric transmission systems, and has barred "no bid" contracts between RTO's and member transmission owners, in part to eliminate the risks of undue discrimination. In contrast, the reforms proposed herein are much more limited in scope.

market power over transportation service, give their marketing affiliates an undue competitive advantage when they give their affiliates information they do not also make available to other marketers." 969 F.2d at 1198. Since Order No. 497 was issued, natural gas transportation has grown more, not less, concentrated. Pipeline affiliate marketers vastly have increased the size and scope of their operations. The suggestion that reform is unnecessary or that current protections should be relaxed because of "new" economic incentives attaching to pipeline affiliate marketing operations is flawed and false. "Just trust us until you catch us violating the standards" is not a convincing foundation for modern regulation of the pipeline-affiliate relationship.

4. The Reporting Requirements Adopted by Order No. 637 Are Not a "Cure-All".

Opponents of regulatory reform argue that the new reporting requirements adopted by Order No. 637 provide all the tools necessary for interested parties (with limitless resources) to ferret out affiliate abuse. This claim, too, is wrong.

Order No. 637 adopted two forms of reporting requirements: transactional reporting and a revised Index of Customers.

a. Transactional Reporting.

Pursuant to 18 C.F.R. § 284.13(b), interstate pipelines are required to post on their Internet web sites in a downloadable file format the following information, which is to remain available for a period not less than 90 days from the date of posting:

1. The full legal name of the shipper; the shipper's identification number; and the full legal name and identification number of the shipper releasing capacity if a capacity release is involved, or an indication that the pipeline is the seller of released capacity;
2. The contract number for the shipper receiving service under the contract and, if applicable, the contract number for the releasing shippers' contract;
3. The rate charged under each contract;

4. The maximum rate, and for capacity release transactions not subject to a maximum rate, the maximum rate that would be applicable to a comparable sale of pipeline services;
5. The duration of the contract;
6. The receipt and delivery points and zones or segments covered by the contract, including the industry common code for each point, zone or segment;
7. The contract quantity or the volumetric quantity under a volumetric release;
8. Special terms and conditions applicable to a capacity release and special details pertaining to a pipeline transportation contract; and
9. Whether there is an affiliate relationship between the pipeline and the shipper or between the releasing and replacement shipper.

It should be noted at the outset that the transactional reports provide no information whatsoever regarding capacity management transactions (information that is required in Index of Customers filings, which are discussed below), or actual usage data; however, with these limitations noted, how user-friendly are these reports? How much information do they provide that would identify affiliate abuse?

To test the "just file a complaint theory," three pipelines were chosen at random: Panhandle Eastern Pipe Line Company; GulfSouth; and El Paso Natural Gas Company. In each case, the object of the test is to determine (1) the transportation path on the system that is most deeply discounted; and (2) to see whether an affiliated marketer is receiving this discount. The time limit for this test was two hours per pipeline. Such a time constraint reflects the need to analyze a piece of data efficiently, as well as effectively.

In each of the cases reviewed below, pipeline websites were in literal compliance with the express directives of 18 C.F.R. § 284.13(b) of the Commission's regulations. In each case, however, the form and content of the information provided was insufficient to permit any timely or meaningful analysis.

i. Panhandle.

We begin at http://messenger.cmsenergy.com/PeplFrameset.asp, reached through links on the Commission's web page. We click on informational reports and then select transactional reporting. Panhandle's web site presents three submenus for firm and interruptible transportation and for capacity release transactions. Each must be analyzed separately.

Consistent with the language of the regulations, Panhandle provides a link under each report category (firm, interruptible and capacity release) to permit the user to download a spreadsheet containing report data. Appendices A, B and C show the results of this download. In each instance, the summary sheet shows basic contract identification data. The data fields on each report are not uniform (for example, on the capacity release report, the approval code is in column n; for firm and interruptible transportation, the same code is column a). More substantively, the downloaded file does not contain any rate information at all. Special terms of the release are suppressed. This precludes analysis of discounts provided system-wide, using the downloaded file presented by Panhandle.

To get any of the transaction specific information we need, it is necessary to click on each individual service requester code for each contract. These files are downloadable, but contain only specific information relating to a single transaction. If a specific contract includes special terms and conditions, these are not included in the downloaded file listing rate and point information, but must be selected and downloaded separately.

The bottom line is that, to answer the questions posed above using transaction reporting data, it would be necessary to download each transaction file listed, each separate special conditions file, and to cut and paste these documents file by file by hand into a user-created spreadsheet. Panhandle lists 51 firm transactions, 58 IT transactions, and 26 capacity release transactions. Only after spending the solid afternoon necessary to create this new spreadsheet can we even begin to attempt to answer the questions listed above. Time constraints preclude completion of this project.

ii. GulfSouth.

We begin at http://www.gulfsouthpl.com and select informational postings. Unlike Panhandle, GulfSouth has only two categories of transactional reports: firm and interruptible. For firm transactions, GulfSouth states that "each cycle, GulfSouth polls the database for new Firm contracts or amendments to such contracts. When found, new records are posted to this report. When information is not found, the report is not updated."

The most recent available report is dated 4/2/2001, and is designated report 4301, effective 4/1/2001. A copy of this report is attached as Appendix D. The report contains information relating to a single contract with Prior Intrastate Corporation under Rate Schedule FTS. The on-screen information for this single transaction appears to be complete; GulfSouth provides a separate downloadable text file under a separate section of its website (labeled "downloads"). A separate link is given to the text of a discount agreement between Koch and Prior Intrastate, which addresses the development of and limitations on discounted rates. (Appendix E). These files are not included in the downloadable version of the reports.

To answer the questions posed above, it would be necessary to download each of the dozens of transactional files Koch posts, download and review all related letter agreements, and incorporate this information into a new spreadsheet. The project cannot be completed in two hours.

iii. El Paso.

We begin at http://ebb.epenergy.com/ebbEPG/ebbman.asp?sPipelineCode=EPNG.

El Paso provides information for firm and interruptible transportation and for released capacity. Unlike Panhandle, El Paso has a menu driven system. We begin with the firm transportation reports, selecting for each field "ALL." The system returns the message that there is no data available. We repeat the process for interruptible transportation, and receive a detailed report which can be downloaded only in .html format (that is, a report format that cannot be imported easily into a spreadsheet, such as Microsoft Excel). The summary contains no point information and no rate information. This must be selected manually for each transaction. There is no obvious way to download the transaction specific data, even on a transaction-by-transaction basis. The "downloads" section of the web page permits downloading of Index of Customers filings, but not transaction specific data.

Capacity release transactions suffer from similar flaws. The only way to get to specific point and rate information is to view each transaction individually, which by itself could take hours. Once reviewed, it appears that much if not all the data necessary to answer the questions raised above would have to be input manually.

Based on these three random studies, it appears that interstate pipelines and their marketing affiliates now have the best of both worlds: the perception that transparency

exists (and that further regulation should be forestalled or ignored) without the troublesome need actually to provide market participants with usable data.

Transactional reports provide the only potential method of tracking affiliate dealings on a timely basis. The flaws in the current on-line transactional reports transcend one or two inconsistent data fields. File formats for downloaded files are inconsistent and in some cases preclude meaningful analysis. There is no meaningful standardization of even basic data presentation across pipelines. We now have only the illusion of market transparency.

b. Index of Customers Filings.

The quarterly Index of Customers filings contain much more data than transactional reports.[7] Information regarding capacity management transactions also is required. However, only firm transportation and storage contracts in effect as of the first day of the calendar quarter for which the report is filed need be disclosed. (Short-term firm transactions, if properly structured, can slip through the cracks).

The Index of Customers is a very imperfect "screen" for affiliate abuse. In order to analyze an Index of Customers filing, the following steps are necessary:

1. Go the Commission's web site under Natural Gas Pipeline Data and select Index of Customers.
2. Select original filed data (the Commission apparently discontinued providing report format data as of July 2000).
3. Select the quarter to be reviewed.
4. Download a .zip file for that quarter.
5. Decompress the .zip file. A screen then appears with files coded with pipeline ID codes with tab delimited extensions.
6. Consult the Index of Customers manual (which apparently was last revised in 1996) to determine the three digit ID code for the pipeline you wish to review.
7. Open the correct .tab file in a spreadsheet, such as Microsoft Excel.
8. Import the file into the Spreadsheet.

[7] 18 C.F.R. § 284.13(c)(2000).

Once the file is open in Excel and reformatted, the data still is not ready for review. Units of measurement differ across pipeline systems and must be standardized by hand, columns do not contain the same type of data. Descriptions of geographic points differ across pipeline systems. Multiple agents may be listed under a given contract. Rate Schedule designations differ across systems, and additional research regarding the nature of particular services referenced in a filing must be obtained. Appendix F is a sample print out of a recent pipeline Index of Customers filing.

In short, the reporting requirements of Order No. 637 are not even working as intended. They do not, and cannot, justify turning a blind eye to the need to regulate effectively the pipeline-affiliate relationship.

3. How Many Traffic Accidents Are Necessary to Justify A Stop Sign?

The structural advantages accruing to pipeline affiliates are obvious. The economic incentives pipelines have to favor affiliates are obvious and were acknowledged extensively in Order No. 497. What then is the rationale for not taking corrective action?

The opponents of regulatory reform complain that there is not yet enough "evidence" of abuse. Yet the Commission has approved consent agreements in KN, Columbia and NGPL dealing with dozens of alleged violations, taking place over periods of years. How many violations does it take to warrant action? How much market distortion is enough?

New industry conditions demand the reforms outlined below.

B. The Commission Should Enhance and Expand Safeguards Against Affiliate Abuse.

1. Reporting Requirements.

Current reporting requirements are helpful, but are far from adequate to curtail pipeline/affiliate dealings. At a bare minimum, the reporting requirements adopted in Order No. 637 must be enhanced so that industry participants can analyze reported data in a user-friendly, standardized format. Pipelines should be required to report actual usage and non-usage of scheduled capacity. Where a marketing affiliate holds a large share of pipeline capacity, the following data should be required:

- ❖ The amount of capacity[8] held by others that the marketing affiliate manages;
- ❖ The amount of capacity released from any holder of FT each month by term of release; whether the capacity is sold for more than the maximum rate; and whether it is recallable, with capacity releases by a marketing affiliate separately identified;
- ❖ The amount of capacity released and not recalled during peak periods (*e.g.,* the consecutive three-day peak or some other measure of peak demand periods);
- ❖ The amount of secondary firm capacity at selected delivery points;
- ❖ The amount of secondary firm capacity interrupted each day, and the point(s) of interruption;
- ❖ The amount of gas sold to non-affiliates by the affiliated marketer;
- ❖ The volume of interruptible transportation that was nominated but did not flow; and
- ❖ The amount of the affiliated marketer's primary firm transportation that was nominated and scheduled for the beginning of the day and did not flow (due to re-nomination or any other factor). This requirement is necessary to determine whether a dominant affiliate capacity holder deliberately is bumping competitor deliveries.

2. Market Monitoring.

No reporting requirements—even those outlined above—will be effective in the absence of an effective market monitoring program. Consequently, the Commission should monitor on an ongoing basis a reasonable number of critical paths or critical

[8] As used in this section, the term "capacity" includes mainline capacity and capacity at receipt and delivery points (particularly at points of interconnection with other interstate pipelines).

receipt points on pipelines for the exercise of affiliate market power. This program could begin as a pilot project covering as few as 20 points and be expanded to encompass as many as 200 points, based on the experience gained through the pilot project. In addition, the Commission should devote adequate resources to frequent random audits and other appropriate market monitoring mechanisms to review pipeline/affiliate relationships. An effective monitoring program can act as a deterrent to anticompetitive behavior and can be a vehicle through which the Commission can let the natural gas industry know what affirmative steps are being taken to ensure that the operation of natural gas markets is free and fair.

3. Infrastructure Improvements.

The Commission should require pipelines expeditiously to install taps to reduce bottlenecks and to construct additional capacity in circumstances in which customers are willing to pay the costs for such expansions.

4. Bidding Procedures.

To address concerns regarding preferential treatment of marketing affiliates and market manipulation by marketing affiliates, bidding procedures should be revised to cap the term of affiliated bids at five years.[9] Affiliates should not be permitted to exercise rights of first refusal. Instead, an open season should be held at the expiration of the contract. If a pipeline and an affiliate change the terms of a contract through private negotiations, a new open season should be required, with competitive bidding for available primary pipeline capacity.

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[9] *See* Request of the Natural Gas Supply Association for Rehearing of Order No. 637, Docket Nos. RM98-10-000, *et al*., at 19-20 (March 10, 2000).

5. Rate Caps.

Where a marketing affiliate controls a large portion of capacity on a given pipeline system, rate caps for capacity released by a marketing affiliate should be restored. This solution addresses in part the structural advantages enjoyed by pipeline affiliate marketers. The Commission to date has not yet come to grips with this issue. The Commission has assumed that pipeline marketing affiliates would have no economic incentive to withhold the capacity that they can acquire more readily by virtue of their affiliation. NGSA believes this assumption is incorrect. The assumption rests on the belief that capacity release and interruptible transportation are both good alternatives for capacity held by the marketing affiliate. Both capacity release and interruptible transportation are subject to disruption by the conduct of the marketing affiliate/capacity holder itself. Neither may be a good alternative, as a result. Further, this belief is supported by a flawed notion that opportunity costs will be sufficient to deter pipeline affiliate abuse in all cases.

6. Scope of Affiliate Definition.

The definition of "marketing affiliate" should be expanded to cover all entities that hold or manage interstate pipeline capacity and that also have a corporate affiliation with the pipeline. These would include affiliated asset managers and electric affiliates, among others.

The current "marketing affiliate" definition is out of sync with the natural gas industry. As the Commission recognized in Order No. 637, pipelines can discriminate in favor of affiliated asset managers, even if they are not shippers of record. Similarly, pipelines have the opportunity to share commercially sensitive third party information

with, *inter alia*, affiliated generation developers as long as they are not engaged in marketing natural gas. These loopholes should be eliminated.

7. Structural Separation.

If violations are discovered that are found to be egregious by the Commission, the Commission should consider requiring complete structural separation (*i.e.,* divorcement) of a pipeline and its affiliated marketers as a regulatory "last resort" to prevent affiliate abuse.

IV. CONCLUSION.

NGSA commends the Commission for holding a staff conference to address these critical issues and urges the Commission to adopt the proposed revisions outlined above to its regulations affecting pipeline affiliate marketers.

Respectfully submitted,

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DATED: April 30, 2001

CERTIFICATE OF SERVICE

Pursuant to Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010 (2000), I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C., this 30th day of April 2001.

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