

Market Transparency  
Follow-up Staff Workshop  
May 19, 2008

Order No. 704 and Form No. 552

# Outline

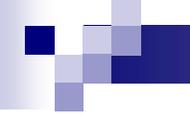
- Disclaimer
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    - VII. Physical Natural Gas
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# Disclaimer

The views that are expressed in this presentation, and that will be expressed at the scheduled staff workshop on May 19, 2008, are those of FERC staff, and do not necessarily represent the views of the Commission, the Chairman, or any individual Commissioner. They are, however, intended to provide staff guidance with respect to Form No. 552. Also, staff will attempt to limit discussions of issues pending on rehearing to technical questions regarding the new form, and staff will not address the policy questions involving the effective date of the rule and the availability of a safe harbor.

# Order No. 704 and Form No. 552

- “Requires that any buyer or seller of more than a de minimis volume of natural gas report aggregate volumes of relevant transactions in ... Commission Form No. 552.” Order No. 704 at P 2.
- The rule focuses on “price formation in spot markets” and accordingly seeks information about the “amount of daily or monthly fixed-price trading that [is] eligible to be reported to price index publishers as compared to the amount of trading that uses or refers to price indices.” Order No. 704 at P 3.
- “The information collected under this requirement is focused specifically on daily and monthly physical spot or ‘cash’ market activity and the contracting based on the prices developed in those markets.” Order No. 704 at P 67.



# Goal of May 19 Workshop

- To address questions submitted prior to the April 22 Technical Conference
- To provide additional guidance on completing Form No. 552

# Structure of Workshop

- Definition VII. Physical Natural Gas from Form No. 552
  - General
  - Inclusions
  - Exclusions
- Other Definitions included in Form No. 552 Instructions
- Form No. 552, Lines 1 through 8
- Miscellany

(Note: Question numbers on subsequent slides reference the question spreadsheet distributed at the April 22 Technical Conference.)

# Physical Natural Gas - General

- Definition focuses on “price formation in the spot markets,” namely “**daily** or **monthly** fixed-price trading that [is] **eligible** to be reported to price index publishers.” Order No. 704 at P 3. (Emphasis added)
- Data eligible to be reported on Form No. 552:
  - Volumes that use next-day or next-month price indices are reportable.
  - If a market participant reports volumes to a price index publisher, it must report those volumes on Form No. 552.
  - If a market participant does not report to a price index publisher, it must nonetheless report on Form No. 552 any volumes that it could have reported to a price index publisher.

# Physical Natural Gas – General (Cont.)

- Physical options contract volumes that are exercised and can contribute to and/or use next-day and next-month price indices are reportable.
- Form No. 552 requires the reporting of contracted volumes and not actual volumes, except for contracts that span more than one calendar year.
- These points respond to questions: 3, 4, 6, 22, 23, 24, 25, 26, 27, 31, 36, 37, 40, 45, 46, 47, 49, 54, 69, 70, 76, 77, 80, 86, 88, 89, 91, 92, 93, 95, 96, 97, 98, 99, 100, 104, 105, 106, 107, 108, 109, and 110.

# Physical Natural Gas – Inclusions Overview

- a. Cash-out, imbalance make-up and operational volumes reported by pipelines.
- b. Volumes attributable to royalty-in-kind transactions, gas provided for processing such as plant thermal reduction, and purchases and sales related to the production and gathering function.
- Contracts that are complex or span more than a calendar year.

# Physical Natural Gas – Inclusions

(a. Cash-out, imbalance make-up and operational volumes reported by pipelines.)

- Cash-out for imbalances owed to a pipeline that can contribute to and/or use a price index are reportable as sales by the pipeline and purchases by the shipper.
  - Gross sales and gross purchases, not net, are reportable by both producers and shippers.
  - Cash-outs in tariffs are reportable.
- Volumes purchased for make-up and imbalance trading of volumes among shippers that can contribute to and/or use price indices are reportable.
- Adjustment volumes for in-kind settlement that can contribute to and/or use price indices are reportable.
- These points respond to questions: 7, 8, 14, 16, 17, 18, 19, 24, 25, 26, 27, 31, 45, 74, 82, 88, and 90.

# Physical Natural Gas – Inclusions

(b. Volumes attributable to royalty-in-kind transactions, gas provided for processing such as plant thermal reduction, and purchases and sales related to the production and gathering function.)

- An operator acting on behalf of joint owners under a Joint Operating Agreement (JOA) and royalty owners report 8/8<sup>th</sup> of portions of volumes that can contribute to and/or use price indices. A joint owning producer does not report if the operator already reports the same volume.
- Any portion of upstream volumes attributable to royalty-in-kind, processing (such as plant thermal reduction), and purchases related to production and gathering that can contribute to and/or use price indices are reportable; however, lease use volumes consumed prior to first sales are not reportable.
- These points respond to questions: 10, 11, 13, 24, 71, 72, and 73.

# Physical Natural Gas – Inclusions

(Contracts that are complex or span more than a calendar year.)

- Multi-year fixed priced contracts are not reportable as they do not contribute to either daily or next-month indices.
- Multi-period index contracts:
  - Order No. 704 seeks to understand “the use of fixed prices and index prices.” Order No. 704 at P 5.
  - Order No. 704 requires “natural gas market participants to report annually.” Order No. 704 at P 1.
  - A market participant's reporting of multi-period contracted volumes in the agreement year would overstate the overall total of index use. Further, the market participant's subsequent filings would understate the use of index in the actual years the obligations were priced by the referenced index contrary to the objective of Order No. 704.
  - Therefore, for multi-period index use only, such as a multi-year index deal or an index deal that spans the calendar year end into a new year, the volumes to be reported on Form No. 552 should only be that portion of the obligation matching the calendar year of the Form No. 552 filing.
- These points respond to questions: 5, 31, 78, 79, 84, 85, 92, 95, 98, 99, 100, 103, 104, and 107.



# Physical Natural Gas – Exclusions Overview

- a. Sales to and purchases by end-users.
- b. Sales or purchases outside the United States of America.
- c. Transactions that take place among affiliates.
- d. Any type of financially-settled transaction.
- e. Volumes traded in futures contracts, even those that go to physical delivery.
- f. Volumes of imported LNG traded prior to re-gasification and exported LNG traded after liquefaction.

# Physical Natural Gas – Exclusions

(a. Sales to and purchases by end-users.)

- Order No. 704 clearly excluded retail sales and purchases from the coverage of the rule. At times, however, the order uses “end-user” interchangeably with “retail customer.”
- Form No. 552 explicitly excludes “sales to and purchases by end-users.”
- While all retail customers are generally end-users, not all end-users are necessarily retail customers.
- The purpose of the rule is to capture the size of the wholesale natural gas market, in particular those sales and purchases that can contribute to and/or use next-day or next-month price indices.
- Therefore, the exclusion of sales to and purchases by all end-users (not just retail customers) from the definition of “physical natural gas” in Form No. 552 is inconsistent with the purpose of Order No. 704.
- These points respond to questions: 7, 12, 19, 20, 21, 28, 33, 36, 43, 44, 46, 47, 48, 49, and 82.



# Physical Natural Gas – Exclusions

(b. Sales or Purchases outside the United States of America.)

- Volumes delivered outside the U.S. and priced at locations outside the U.S. are not reportable.
- Volumes originating from inside the U.S. and delivered outside the U.S., and priced at locations inside or outside the U.S., are reportable.
- Volumes delivered inside the U.S. and priced at locations inside or outside the U.S. are reportable.
- These points respond to questions: 29, 31, 36, 40, 57, and 95.

# Physical Natural Gas – Exclusions

(c. Transactions that take place among affiliates.)

- “A transaction between affiliates is not part of the price formation process in wholesale natural gas markets.” Order No. 704 at P 110.
- This point responds to questions: 36, 60, and 94.

# Physical Natural Gas – Exclusions

(d. Any type of financially-settled transactions.)

- A transaction without a physical contractual component is not reportable.
  - E.g., pure financial swaps are not reportable.
  - E.g., physical trades (netted) that settle financially such as book-outs which can contribute to and/or use price indices are reportable.
- This point responds to questions: 15, 36, and 95.

# Physical Natural Gas – Exclusions

(e. Volumes traded in futures contracts, even those that go to physical delivery.)

- Questions regarding transactions such as trigger deals that use the NYMEX futures price as a price index are clarified under “VI. Next-Month Delivery.”
- Physical daily and next-month cash deals that utilize financial clearing are reportable and are not considered exchange-traded futures for the purpose of filing Form No. 552.
- These points respond to question 36.

# Physical Natural Gas – Exclusions

(f. Volumes of imported LNG traded prior to re-gasification and exported LNG traded after liquefaction.)

- Volumes associated with purchases or sales of physical natural gas after re-gasification at LNG terminals interconnected to the U.S. grid for deliveries in the U.S. that can contribute to and/or use next-day or next-month indices are reportable (see also slide 15).
- This point responds to question 36.



# Other Definitions - Overview

- IV. Fixed Price
- V. Next-Day Delivery
- VI. Next-Month Delivery
- VIII. Price Index Publisher
- X. Quantity
- XI. Reportable Locations
- XIV. Wholesale Natural Gas Purchases
- XV. Wholesale Natural Gas Sales

# Other Definitions - Fixed Price

- “Physical Basis transactions that refer directly to futures prices...are not ‘Fixed Price’ transactions.” Order No. 704 at P 65 (b).
  - Publishers, under some circumstances, consider physical basis transactions as fixed price deals.
  - Physical basis transactions always use the final NYMEX settlement price of the terminating futures contract and therefore always use the NYMEX as an index. Therefore, physical basis transactions are reportable on line 5 of Form No. 552.
  - Physical basis transactions also can contribute to index formation. Although Form No. 552 only recognizes fixed price deals as index forming, physical basis transactions should also be reported on line 4 of Form No. 552.
  - Form No. 552 allows for multiple reporting of hybrid transactions such as physical basis transactions, which both use and contribute to an index.

## Other Definitions - Fixed Price (Cont.)

- Physical trigger or “NYMEX plus” transaction volumes when executed outside of bid week are not reportable.
- Physical trigger or “NYMEX plus” transaction volumes when executed at prices other than a NYMEX settlement price during bid week that can contribute to a next-month index are reportable.
- Physical trigger or “NYMEX plus” transaction volumes that use a NYMEX settlement price during bid week that can contribute to a next-month index are reportable.
- These points respond to questions: 2, 9, 30, 32, 34, 35, 75, and 101.

# Other Definitions - Next-Day Delivery

- Fixed price transactions that meet the next-day delivery criteria in the definition and can contribute to price indices are reportable. Contracts that use next-day price indices include those that are transacted in advance of the price index formation.
- Reportable next-day fixed price transactions that are actually reported to publishers are used to calculate the next-day price indices.
- These points respond to questions: 4, 98, and 106.

# Other Definitions - Next-Month Delivery

- Fixed price transactions that meet the next-month delivery criteria in the definition and can contribute to price indices are reportable. Contracts that use next-month price indices include those that are transacted in advance of the price index formation.
- Reportable next-month fixed price transactions that are actually reported to publishers are used to calculate the next-month price indices.
- These points respond to questions: 4, 93, 98, and 106.

# Other Definitions - Price Index Publisher

- Commission Staff will make a best effort to list reportable locations and publishers on the Commission's website, yet it is the market participants' obligation to file accurately.
  - "Commission Staff will maintain a list of relevant 'Price Index Publishers' with links to their descriptions of their processes for receiving price information." Order No. 704 at P 65 (f).
  - "Commission Staff will post each year a list for the coming year of current 'Reportable Locations' for each price publisher." Order No. 704 at P 15.
- As of May 2008, there are 11 Commission-approved price index developers (respondents to Docket No. PL03-3-005).
- NYMEX is not recognized as a Commission-approved index publisher, yet the natural gas industry is dependent on NYMEX trading, its products, and its indices.
- Other publications may now use and certainly may later create next-day and next-month indices that the natural gas market depends on that are not approved, recognized or known by the Commission.
- These points respond to questions 105 and 108.

# Other Definitions – Quantity

- Dekatherm (Dth) is a straight conversion to MMBtu, which when multiplied by one million (1,000,000) becomes 1 TBtu.
- The threshold volume for filing Form No. 552 should be rounded to the nearest tenth of a TBtu (2.2 TBtu), all numbers on the form should be rounded similarly. The terms “quantity” and “volume” are interchangeable and all volumes should be measured in TBtus.
- These points respond to questions 58 and 59.

# Other Definitions - Reportable Locations

- There may be reportable locations from publishers that are not linked to the Commission's website. If they can contribute to and/or use price indices, they are reportable. Market participants with this knowledge are urged to inform the Commission so that the links can be added.
- Form No. 552 requires aggregate reporting of volumes that can contribute to and/or use price indices, thus obviating the issue of publishers having slightly different definitions of price index locations.
- These points respond to questions: 38, 39, 41, 42, 89, 102, 105, and 108.

# Other Definitions - Wholesale Natural Gas Purchases and Wholesale Natural Gas Sales

- The exclusion of purchases by and sales to end-users is an issue that is subsumed in the issue related to the exclusion of “end-user” from the definition of “physical natural gas” in Form No. 552.
- The use of the word “purchases” in the definition of “Wholesale Natural Gas Sales” is an error.
- For both definitions, the purpose of the rule controls – to capture volumes of transactions that can contribute to and/or use next-day or next-month price indices.
- These points respond to questions: 36, 44, and 48.

# Form No. 552, Line 1

- Includes buy and/or sell volumes.
- Information reported on Form No. 552 is not intended to refer to Form No. 2.
- Volumes should be reported in aggregate.
- Volumes that cannot contribute to and/or do not use price indices are excluded.
- These points respond to questions: 67, 80, 83, 87, and 89.

# Form No. 552, Lines 2 through 5

- Line 2 – Aggregated volumes at fixed prices for next-day delivery that can contribute to next-day price indices are reportable.
- Line 3 – Aggregated volumes that use next-day price indices are reportable.
- Line 4 – Aggregated volumes at fixed prices for next-month delivery that can contribute to next-month price indices are reportable.
- Line 5 – Volumes that use next-month price indices are reportable, even if delivered to a location different from the price index location.
- These points respond to questions: 89, 99, and 100.

## Form No. 552, Lines 6 through 8

- Line 6 – Volumes that can contribute to and/or use price indices that are neither next-day nor next-month price indices need not be reported.
- Line 7 – For purchase volumes, explain if the total for lines 2 through 6 does not equal line 1.
- Line 8 – For sales volumes, explain if the total for lines 2 through 6 does not equal line 1.
- These points respond to questions 81 and 96.

# Miscellany

- If a Joint Action Agency (JAA) purchases an annual amount of gas above the de minimis level for use by its members, it must report the aggregate wholesale purchase on Form No. 552. The transfer of that purchase to the JAA's members is not required to be reported as a wholesale sale. However, if the JAA takes title for the gas when purchasing it and resells the gas to the member, both entities must report. A member can delegate reporting to the JAA. (Questions 50 and 86)
- All filings will be made electronically. Updates on the status of the form will be posted on the website. (Question 51)

## Miscellany (cont.)

- Form No. 552 must be signed by an officer of the corporation, trust, association, or other organized group on behalf of which the filing is made. (Question 1)
- All holders of a blanket sales certificate or a blanket unbundled sales certificate must file Form No. 552. (Question 52)
- Order No. 704 provides for the protection of proprietary information by requiring information to be reported on an aggregated basis and by not requiring the reporting of price information or transaction-specific information. Order No. 704 at P 83. (Question 53)

## Miscellany (cont.)

- Sales or purchases that are equal to or that exceed the 2.2 TBtu de minimis threshold must be reported. (Question 56)
- In determining the de minimis threshold, exclusions or offsets may not be applied. (Question 68)
- Filings are required to be resubmitted to correct data found to be inaccurate, but not to true-up for actualized delivery. (Question 61)
- A corporate entity may file on behalf of affiliates with consolidated numbers but must report whether or not each affiliate has a blanket unbundled sales or marketing certificate. (Question 62 and 111)



Thank you.