

132 FERC ¶ 61,064
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

Arizona Public Service Company and
Sequent Energy Management, L.P.

Docket No. PR10-45-000

ORDER DENYING REQUEST FOR CLARIFICATION AND GRANTING LIMITED
WAIVER

(Issued July 23, 2010)

1. On June 25, 2010, Arizona Public Service Company (APS) and Sequent Energy Management, L.P. (Sequent) (collectively, Petitioners) submitted a joint petition seeking clarification that the proposed agreement described in their petition is not a prohibited buy/sell transaction as contemplated by the Commission's capacity release rules, regulations and policies. Alternatively, Petitioners request a limited waiver with respect to the proposed agreement should the Commission determine that it is a prohibited buy/sell transaction. As discussed below, the Commission denies Petitioners request for clarification, but finds that good cause exists to grant Petitioners' request for a limited waiver of the Commission's buy/sell prohibition in order to allow the proposed transaction to proceed.

I. Details of Filing

2. Petitioners state that APS is Arizona's largest electric utility company and serves more than 1.1 million customers throughout the state. Petitioners state that Sequent purchases and sells natural gas and provides asset management and other energy-related services to customers throughout the United States.

3. According to their joint petition, APS has been assessing how best to meet the fuel needs of its 4,470 MW of natural gas power generation facilities. Petitioners state that APS's transportation capacity on El Paso Natural Gas Company and Transwestern Pipeline Company can be curtailed if APS is not in balance during critical operating periods and that gas storage is an essential service needed by APS to remain in balance and to maintain reliable electric service. Petitioners contend that, for operational reasons, this gas storage must be located where it can be accessed through APS's interstate capacity on very short notice. However, to date, APS has not been able to obtain access

to strategically-located natural gas storage for its operations through traditional means such as procurement, independent development, delivery alternatives, and open season bidding. Nor does APS anticipate that this will change in the near future.

4. Accordingly, APS proposes to enter into an agreement with Sequent for an initial 12-month period whereby APS will have the right to deliver gas to Sequent at specified delivery points at Chevron Keystone Gas Storage, LLC (Keystone Storage). Petitioners state that under the proposed agreement title to the gas will pass from APS to Sequent at the delivery point. APS will have the right to require Sequent to redeliver gas to APS at specified delivery points at Keystone Storage and title to the gas will pass from Sequent to APS at the delivery point. Petitioners state that once APS delivers the gas to Sequent, APS has no control over the gas and may not direct Sequent's actions with respect to such gas. Sequent, they state, may keep the gas in storage at Keystone Storage, move the gas to a different storage facility or sell the gas to a third party depending on current market conditions. Further, when gas is redelivered to APS from Sequent, APS has no control over where Sequent sources the gas.¹

5. Keystone Storage is a high deliverability salt cavern natural gas storage facility located in Winkler County, Texas. Petitioners state that Keystone Storage is a Hinshaw pipeline² with a limited blanket certificate pursuant to section 284.224 of the Commission's regulations to provide certain storage and hub services in interstate commerce pursuant to its Operating Statement.

6. Petitioners state that the initial term of the proposed agreement will be twelve months and APS has the option to extend the agreement if it determines that to be in the best interests of its customers. At the end of the term of the agreement, the parties intend that the amount of gas that was originally delivered by APS to Sequent will be equal to the aggregate amount that is ultimately redelivered by Sequent to APS, thus achieving a

¹ Petitioners state that Sequent will use its asset portfolio to find the best possible use for such gas based on the market conditions existing at the time.

² Section 1(c) of the Natural Gas Act (NGA) exempts from the Commission's NGA jurisdiction those pipelines which transport gas in interstate commerce if (1) they receive natural gas at or within the boundary of a state, (2) all the gas is consumed within that state and (3) the pipeline is regulated by a state Commission. This exemption is referred to as the Hinshaw exemption after the Congressman who introduced the bill amending the NGA to include section 1(c). *See ANR Pipeline Co. v. Federal Energy Regulatory Comm'n*, 71 F.3d 897, 898 (1995) (briefly summarizing the history of the Hinshaw exemption).

zero balance. Petitioners state that for this proposed service, APS will pay Sequent a fixed monthly fee and volumetric charges that correlate to Sequent's costs to inject and withdraw gas at Keystone Storage.

7. Petitioners contend that this proposed agreement offers APS a means to secure, on short notice, ready access to natural gas to fuel its power generation facilities, which, in turn, will allow APS to better balance the receipts and deliveries of natural gas transported under APS's interstate transportation contracts. Petitioners believe the contemplated transaction is lawful and would not violate any of the Commission rules, regulations or policies. However, out of an abundance of caution, they are seeking a confirming clarification that the proposed agreement is not in violation of Part 284 capacity release rules, regulations and policies, specifically, the buy/sell prohibition. In support of their request, Petitioners rely on the fact that the receipt and delivery points of the transactions at issue are on a Hinshaw facility that is not required to comply with the Commission's capacity release rules promulgated under Order No. 636. Petitioners state that there are also no upstream interstate capacity rights tied to the transactions. If the Commission determines that it is not appropriate at this time to provide confirming clarification, Petitioners request limited waivers of the Commission's capacity release regulations and policies to the extent they would otherwise apply to the contemplated agreement.

8. Petitioners contend that the Commission has established that Hinshaw facilities, such as Keystone Storage, are not subject to all of the requirements of Order Nos. 636 and 637, including capacity release and that there are no known orders issued by the Commission applying these policies to a Hinshaw facility. Petitioners state that they are also not aware of any policy reason why the prohibition on buy/sell arrangements should apply to a Hinshaw facility such as Keystone Storage. Petitioners contend that in Order No. 636, the Commission prohibited buy/sell arrangements to prevent the circumvention of the Commission's capacity release regulations, which require capacity to be posted and subject to bidding on a non-discriminatory basis. Petitioners contend that Keystone Storage is a Hinshaw facility not subject to the capacity release restrictions of Order No. 636 and therefore, there is no concern that the structure of the proposed transaction would circumvent any capacity release regulations.

9. Petitioners also contend that the Commission's definition of a prohibited buy/sell indicates that the proposed agreement is not a prohibited buy/sell agreement. Citing various Commission's orders, Petitioners argue that, "A prohibited buy-sell transaction is a commercial arrangement where a shipper holding interstate pipeline capacity buys gas at the direction of, on behalf of, or directly from another entity (e.g., an end-user), ships that gas through its interstate pipeline capacity, and then resells an equivalent quantity of gas to the downstream entity at the delivery point," and Sequent's storage capacity that is the subject of this transaction is on a Hinshaw facility and is not "interstate pipeline capacity" transportation.

II. Public Notice, Intervention and Comments

10. Public notice of Petitioners' filing was issued on June 30, 2010. Interventions and protests were due as provided in section 154.210 of the Commission's regulations, 18 C.F.R. § 154.210 (2010). Pursuant to Rule 214, 18 C.F.R. § 385.214 (2010), all timely filed motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt this proceeding or place additional burdens on existing parties. No protests or adverse comments were filed.

III. Discussion

11. As discussed below, the Commission denies Petitioners' request for clarification, but finds that good cause exists to grant Petitioners' request for a limited waiver of the Commission's prohibition against buy/sell transactions to the extent necessary to allow the proposed agreement to proceed.

12. Petitioners have raised an issue which the Commission has not previously addressed – whether the prohibition on buy/sell transactions applies to interstate open-access transportation services provided by (1) intrastate pipelines pursuant to section 311 of the Natural Gas Policy Act of 1978 (NGPA)³ and (2) Hinshaw pipelines pursuant to blanket certificates issued under section 284.224 of the Commission's regulations.⁴ Subpart C of the Commission's Part 284 open-access regulations implements the provisions of NGPA section 311 concerning transportation by intrastate pipelines.⁵ Section 284.224 provides for the issuance of blanket certificates to Hinshaw pipelines to provide open-access transportation service “to the same extent that, and in the same manner” as intrastate pipelines are authorized to perform such service by Subpart C of the Commission's Part 284 open-access regulations. Those regulations require intrastate and Hinshaw pipelines performing interstate service to do so on an open-access basis.⁶ However, the Commission exempted intrastate and Hinshaw pipelines from the

³ 15 U.S.C. § 3371(a)(2) (2006).

⁴ 18 C.F.R. § 284.224 (2010).

⁵ 18 C.F.R. § 284.121-126 (2010).

⁶ 18 C.F.R. §§ 284.7(b), 284.9(b) and 284.122 (2010).

requirements of Order No. 636, including capacity release, electronic bulletin boards (now internet websites) and flexible receipt and delivery points.⁷

13. Traditionally, a prohibited buy/sell transaction is a commercial arrangement whereby a shipper holding interstate pipeline capacity buys gas at the direction of, on behalf of, or directly from another entity (e.g., an end-user), ships that gas through its interstate pipeline capacity, and then resells an equivalent quantity of gas to the downstream entity at the delivery point.⁸ Prior to Order No. 636, the Commission permitted interstate pipelines regulated under the NGA to obtain certificates for capacity brokering programs that would allow customers to assign their capacity to other customers and to engage in certain “buy/sell” programs.

14. In Order No. 636, however, the Commission decided that it could not monitor the certificated capacity brokering programs adequately to ensure against undue discrimination in the allocation of capacity.⁹ The Commission explained that “there are simply too many potential assignors of capacity and too many different programs for the Commission to oversee.”¹⁰ As a result and in an effort to provide greater assurance that transfers of capacity from one shipper to another were transparent and not unduly discriminatory, the Commission adopted a nationally uniform capacity release program requiring capacity to be posted and subject to bidding on a non-discriminatory basis. In addition, in concurrent orders, the Commission terminated the capacity brokering program¹¹ and stated it would not authorize any more buy/sell transactions.¹² The

⁷ *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation and Regulation of Natural Gas Pipeline After Partial Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs. ¶ 30,939, *order on reh'g*, Order No. 636-A, FERC Stats. & Regs. ¶ 30,950, *order on reh'g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992), *order on reh'g*, 62 FERC ¶ 61,007 (1993), *aff'd in part and remanded in part sub nom. United Distribution Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997), *order on reh'g*, Order No. 636-D, 83 FERC ¶ 61,210 (1998).

⁸ *See Williams Energy Marketing & Trading Co.*, 92 FERC ¶ 61,219, at 61,715-16 (2000).

⁹ Order No. 636, FERC Stats. & Regs. ¶ 30,939 at 30,416.

¹⁰ *Id.*

¹¹ *Algonquin Gas Transmission Co., et al.*, 59 FERC ¶ 61,032 (1992).

¹² *El Paso Natural Gas Co., et al.*, 59 FERC ¶ 61,031 (1992).

Commission believed that to permit buy/sell transactions to utilize interstate pipeline capacity after the capacity release mechanism went into effect would frustrate the new, nationally uniform program.¹³

15. Petitioners contend that the Commission's buy/sell prohibition is inapplicable here because the buy/sell prohibition was intended to prevent the circumvention of the Commission's capacity release program instituted in Order No. 636 and Keystone Storage is a Hinshaw facility not subject to the capacity release restrictions of Order No. 636. Petitioners correspondingly contend that their proposed transaction does not meet the definition of a prohibited buy/sell transaction because the capacity that is the subject of the proposed agreement is on a Hinshaw facility and is not "interstate pipeline capacity" transportation.

16. Petitioners have requested, in essence, that the Commission grant a blanket authorization for all interstate shippers on NGPA section 311 intrastate and Hinshaw pipelines to engage in buy/sell transactions. The Commission is unwilling to grant such a blanket authorization. While Order No. 636 adopted the prohibition on buy/sell transactions in conjunction with the creation of the capacity release program for interstate pipelines, the prohibition on buy/sell transactions, together with the shipper-must-have-title rule, play a more fundamental role than just preventing the circumvention of the capacity release program. These rules help enforce the central requirement of the Commission's Part 284 regulations that all open-access pipelines, including NGPA section 311 intrastate pipelines and Hinshaw pipelines, "must provide such service without undue discrimination, or preference."¹⁴ They do this by ensuring that capacity is allocated among shippers in a transparent manner based on the procedures and not unduly discriminatory priorities in the pipeline's Commission-approved tariff, either for the direct sale of capacity by the pipeline or for capacity release by firm shippers.

17. Order No. 636 adopted the capacity release program for interstate pipelines in order to eliminate the potential for firm capacity holders to unduly discriminate in the reassignments of capacity. In concurrent orders, the Commission terminated the capacity brokering program and stated it would not authorize any more buy/sell transactions because it no longer believed that it could adequately monitor such programs to ensure against undue discrimination. The capacity release program addressed those concerns by,

¹³ *Id.* at 61,080.

¹⁴ This requirement is set forth in sections 284.7(b)(1) and 284.9(b) of the Commission's regulations, which are applicable to intrastate and Hinshaw pipelines providing service under Subpart C of the Part 284 regulations.

among other things, requiring that all reassignments are transparent. Order No. 636 prohibited private transfers of capacity between shippers and, instead, required that all release transactions be conducted through the pipeline. Therefore, when a releasing shipper releases its capacity, the replacement shipper must enter into a contract directly with the pipeline, and section 284.13(b) requires the pipeline to post information about the replacement shipper's contract including any special terms and conditions.¹⁵ In addition, the capacity release program requires certain categories of releases to be posted for bidding.

18. As Petitioners point out, the Commission does not require section 311 and Hinshaw pipelines to include capacity release provisions in their tariffs, nor have any such pipelines done so. However, it does not follow from this fact that the prohibition on buy/sell transactions is unnecessary. Rather, the absence of a capacity release program for section 311 and Hinshaw pipelines means that their tariffs contain no provisions to ensure that capacity reassignments by shippers are transparent and non-discriminatory. In these circumstances, a blanket authorization of buy/sell transactions would allow holders of capacity on such pipelines to privately contract to allow another party to make use of their capacity without informing the pipeline or publicly disclosing the transaction. This would create the same potential for discrimination and inability of the Commission to monitor capacity reassignment which led to the adoption of the capacity release program as the sole method for capacity reassignment on interstate pipelines. In fact, when the Commission grandfathered certain existing buy/sell transactions at the time of Order No. 636, it did so subject to the condition that participants in such transactions disclose them to the pipeline and required the pipeline post them so as to ensure transparency.¹⁶ For these reasons, the Commission will not grant a blanket authorization for shippers on section 311 and Hinshaw pipelines to engage in buy/sell transactions.

¹⁵ As Order No. 636 emphasized:

The main difference between capacity brokering as it now exists and the new capacity release program is that under capacity brokering, the brokering customer could enter into and execute its own deals without involving the pipeline. Under capacity releasing, all offers *must* be put on the pipeline's electronic bulletin board and contracting is done directly with the pipeline.

Order No. 636, FERC Stats. & Regs. ¶ 30,939 at 30,420 (emphasis in original).

¹⁶ See *Algonquin*, 59 FERC at 61,096; *El Paso*, 59 FERC at 61,080-81.

19. However, the Commission recognizes that capacity reassignments can promote more efficient use of firm pipeline capacity by enabling a holder of such capacity to permit its capacity to be used by another party for a higher valued use.¹⁷ Therefore, given the absence of any generic capacity reassignment programs on section 311 and Hinshaw pipelines, the Commission is willing, on a case-by-case basis, to consider requests for waiver of the buy/sell prohibition, where it can be shown that a particular buy/sell transaction provides significant benefits to the market. Such waiver requests will ensure that any buy/sell transactions are transparent and can be monitored for undue discrimination.

20. The transaction proposed by APS and Sequent in the instant proceeding is clearly a buy/sell transaction. Under Petitioners' proposed agreement, APS will have the right to deliver gas to Sequent at Keystone Storage. Title to such gas will pass from APS to Sequent at the delivery point. APS will have the right to require Sequent to redeliver gas to APS at specified delivery points at Keystone Storage and title to the gas will pass from Sequent to APS at the delivery point. APS will pay Sequent a fixed monthly fee and volumetric charges that correlate to Sequent's costs to inject and withdraw gas at Keystone Storage. As described above, a prohibited buy/sell transaction is a commercial arrangement whereby a shipper holding interstate pipeline capacity buys gas at the direction of, on behalf of, or directly from another entity (e.g., an end-user), ships that gas through its interstate pipeline capacity, and then resells an equivalent quantity of gas to the downstream entity at the delivery point. We find that the proposed agreement is the equivalent of the buy/sell transactions described in the numerous cases cited by Petitioners and previously prohibited by the Commission, which effectively allows APS to use Sequent's storage capacity. The fact the parties view the arrangement as the equivalent of a reassignment of Sequent's storage capacity to APS is shown by APS's agreement to pay Sequent a rate correlated to Sequent's payments to Keystone Storage for the use of the capacity.

21. However, despite the Commission's unwillingness to grant a generic authorization of buy/sell transactions with respect to the jurisdictional services of Hinshaw facilities, the Commission finds that, in this case, good cause exists to grant Petitioners a limited waiver of the Commission's buy/sell prohibition for the initial 12-month period of the agreement in order to allow the proposed agreement to proceed. Petitioners contend that, given APS's daily and hourly gas needs to run its gas-fired electric generators, storage is an essential service needed by it to remain in balance on El Paso and Transwestern and thereby minimize its costs of transportation service on those pipelines and maintain reliable electric service for its customers throughout the state of Arizona. However, APS

¹⁷ See Order No. 636, FERC Stats. & Regs. ¶ 30,939 at 30,418.

has been unable to obtain strategically-located natural gas storage through traditional means such as procurement, independent development, delivery alternatives, and open season bidding and nor does it anticipate that this will change in the near future. The proposed agreement offers APS a means to secure, on short notice, ready access to natural gas to fuel its power generation facilities, which, in turn, will allow APS to better balance the receipts and deliveries of natural gas transported under APS's interstate transportation contracts and maintain reliable electric service. No party has protested the request or claimed that it would be harmed by the transaction. The transaction thus allows Sequent's storage capacity on Keystone to be used in a manner which will benefit electric consumers in Arizona.

22. Given these circumstances and the potential public benefit, we find that good cause exists to grant Petitioners a limited waiver of the Commission's buy/sell prohibition for the initial 12-month period of the agreement in order to allow Petitioners to proceed with the transaction.¹⁸

The Commission orders:

(A) The Commission denies Petitioners' request for clarification, as discussed in the body of this order.

(B) The Commission finds that good cause exists to grant Petitioners' request for a limited waiver of the Commission's buy/sell prohibition for the initial 12-month period of the agreement in order to allow the proposed agreement described in this order to proceed.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

¹⁸ This limited waiver is without prejudice to Petitioners seeking an extension of the waiver if they ultimately decide to extend the agreement.