ACC Energy Committee Webinar

Natural Gas Transportation and Storage Capacity Contracts

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July 14, 2010
Agenda

• Focus = Interstate Capacity
• Negotiating transportation and storage service agreements for existing capacity
• Negotiating transportation and storage precedent agreements and service agreements for new capacity
• Entering into prearranged capacity release agreements and bidding for released capacity
• How to contract for a “bona fide” asset management agreement
Types of Pipeline and Storage Capacity

• Interstate
  ▪ Regulated by FERC
  ▪ Rates, terms and conditions are approved by FERC
  ▪ Key policies: open access, not unduly discriminatory, transparency

• Section 311
  ▪ Under the Natural Gas Policy Act, intrastate pipelines allowed to provide interstate service
  ▪ Statement of Operating Conditions filed at FERC

• Hinshaw / Intrastate / Gathering
  ▪ Regulated by state commission
  ▪ Some rates, terms and conditions may be negotiated
Contracting For Existing Capacity
Existing Interstate Capacity

- Open and transparent access for awarding capacity
  - Auction process on pipeline “electronic bulletin board”
  - Terms and conditions governed by FERC-approved tariff
- Most flexibility in rates for service
  - Maximum rate
  - Discount rate
    - Non-discriminatory basis to similarly situated shippers
  - Negotiated rate
  - Market-based rate
    - Mostly for independent storage providers
Common Tariff Provisions – Negotiable

- Term
- Rate
- Quantity
- Receipt and Delivery Points
- Injection and withdrawal rights
- Flow rights
Common Tariff Provisions – Not Negotiable

- **Title**
  - Shipper must have title

- **Risk of Loss / Possession / Control**
  - Varies depending on pipeline

- **Force Majeure**
  - Payment of demand charges still required; partial reservation charge crediting immediately or full crediting after period of time (e.g., 10 days)

- **Creditworthiness**
  - 3 months demand charges

- **Billing and Payment**
  - Monthly
Common Tariff Provisions – Not Negotiable (cont’d)

• Capacity Release
  ▪ Capacity can be temporarily or permanently “assigned” per FERC’s capacity release rules

• Nominations and Scheduling
  ▪ Follows NAESB guidelines

• Curtailment
  ▪ Interruptible and park and loan services cut first
  ▪ Firm, last to be cut
Permissible “Non-Conforming” Provisions

• Process
  ▪ Pipeline files at FERC for permission as non-conforming
    ▪ Permissible deviation if no risk of undue discrimination
    ▪ Offer to provide to similarly situated shippers
  ▪ Cannot have negotiated terms and conditions of service
    ▪ **Unless:** included in pipeline’s tariff; no risk of undue discrimination

• Examples:
  ▪ Early termination rights
  ▪ Credit requirements
  ▪ Limitation on liability
  ▪ Modification by law
Contracting for New Capacity
The Precedent Agreement

- Open Season for new projects
- Negotiate precedent agreement
  - Flexibility to negotiate service terms and conditions
    - Seasonal rights and rates
    - Enhanced injection and withdrawal rights; flow rights
  - Rates – incremental, rolled-in, negotiated?
    - Rate reduction tied to failure to achieve in-service date
  - Additional credit requirements likely
  - Right of first refusal for future expansions
The Precedent Agreement (cont’d)

• Term and termination options can be negotiated
  ▪ Phased-in in-service dates tied to production
  ▪ Early termination in the event of upstream production concerns
  ▪ ROFRs
The Service Agreement

• Service agreements
  - If non-conforming provisions survive the precedent agreement, need to be filed for FERC approval
  - May require tariff filing
Obtaining Released Capacity
FERC’s Capacity Release Program

• Prior to Order No. 636, LDCs held most interstate pipeline capacity
  ▪ FERC approved capacity brokering programs to facilitate the allocation of excess capacity; capacity was brokered via “buy-sell” arrangements
  ▪ Order No. 636 ended capacity brokering and implemented FERC’s capacity release program

• In order to facilitate FERC’s capacity release program, FERC created policies designed to create a robust secondary market for capacity
  ▪ Shipper-must-have-title
  ▪ Buy-sell prohibition
  ▪ Promotes transparency and allocation of capacity to the shipper that values it most
Posting and Bidding Requirements

• All capacity releases must be posted on pipeline’s electronic bulletin board

• Generally a 3-step process
  ▪ Step 1: Pipeline posts releasing shipper’s offer to release
  ▪ Step 2: Pipeline accepts bids from potential replacement shippers
  ▪ Step 3: Pipeline allocates capacity to the highest bidder (NPV or other specified method)

• Note: any Replacement Shipper must meet the pipeline’s creditworthiness standards (prior to bidding)
Prearranged Capacity Release

- Releasing Shipper may designate a Replacement Shipper to receive capacity
- With 4 exceptions, still subject to FERC’s bidding requirements
- Designated Replacement Shipper will be given opportunity to match the highest bid
Exceptions to Bidding Requirement

• Bidding is **NOT** required if:
  - Release is for a term that is greater than one year (a “long-term” release) AT the maximum pipeline rate
    - Note: this is a recent change, previously any maximum rate release (including “short-term”) was not subject to bidding
  - Discounted short-term releases of 31 days or less
  - Releases pursuant to a “bona fide” asset management agreement
  - Releases pursuant to a state-regulated retail access program
Limits on Discounted Releases for 31 days or less

- No rollovers or extensions
- No back-to-back releases
  - 28 day waiting period
  - Also, watch for “flipping”
    - “Repeated short-term releases of discounted rate capacity to two or more affiliated replacement shippers on an alternating monthly basis in order to avoid the competitive bidding requirement for discounted long-term capacity releases” (BP Oct 2007)
Flexibility in Capacity Releases

- Recently, FERC removed rate cap on short-term releases
  - Capacity can be awarded at market-based rates
  - If Replacement Shipper pays a rate that is higher than the underlying contract rate paid to the pipeline, the Releasing Shipper is permitted to retain the excess
- Prearranged releases still allowed
- Can negotiate:
  - Point changes
  - Recall and reput rights
  - Termination rights
  - Tying arrangement permitted if “bona fide” AMA
  - Can release storage capacity and gas in storage
Negotiating Asset Management Arrangements
Asset Management Agreement

- Capacity releases with strings attached
- Most basis structure
  - An agreement whereby Party A (the “Asset Manager”) agrees to manage gas supply and delivery arrangements, including transportation and storage capacity, for Party B (typically an end user or supplier that holds pipeline capacity)
  - Party B (the “Releasing Shipper”) temporarily releases all or a portion of the capacity along with any associated gas production and gas purchase agreements to the Asset Manager
  - The Asset Manager uses that capacity to serve the Releasing Shipper, and when capacity is not needed to serve Releasing Shipper, the Asset Manager uses that capacity for other purposes
AMAs (cont’d)

• Three FERC rules created barriers for AMAs
  - **Capacity Tying Prohibition** – generally, shippers must not place extraneous conditions on capacity releases.
    - **Problem**: gas supply obligations could be viewed as prohibited tying arrangements
  - **Maximum Rate** – Releases for more than one year must not exceed the maximum applicable tariff rate.
    - **Problem**: profit sharing arrangements and discounts on gas supply could be imputed to the rate paid by asset manager, resulting in rates above maximum rate
  - **Bidding Requirement** – Releases for one year or less, and releases for less than maximum rate, generally must be posted on pipeline websites for bidding.
    - **Problem**: AMAs could be required to be biddable, which would frustrate the parties’ ability to structure AMAs in most efficient manner
The good news …

• FERC concluded that AMAs are desirable and lead to more efficient allocation of capacity

• In Order No. 712, FERC Granted exemptions to address the barriers to AMAs
  ▪ **Capacity Tying Prohibition** – *bona fide* AMAs are expressly exempted from the tying prohibition
  ▪ **Maximum Rate** – fees and profit sharing associated with *bona fide* AMAs are not applied to the rate paid for purposes of compliance with the maximum rate cap
  ▪ **Bidding Requirement** – *bona fide* AMAs must be posted, but they are exempt from bidding, regardless of the term or rate
What is a “Bona Fide” AMA

- To qualify for the exemption, an AMA must be “bona fide”
  - "Bona fide AMA" is one in which the replacement shipper is obliged to supply natural gas to the releasing shipper or receive natural gas from the releasing shipper (ostensibly using the released capacity)
  - For end-user AMAs, releasing shipper must have call option for gas equal to 100% of the daily contract demand under the capacity release during the lesser of 5 months out of 12 or the term of the release
  - For supply-side AMAs, releasing shipper must have put option for gas equal to 100% of the daily contract demand under the capacity release during the lesser of 5 months out of 12 or the term of the release
What is a “Bona Fide” AMA (cont’d)

- If the term is for more than 12 months, any remainder less than 12 months must include a call option of at least 5/12 the remainder
- If more than one piece of capacity, put or call option applies to each segment of the transportation or storage
- If capacity to be released under the AMA is storage, the Asset Manager’s delivery or purchase obligation need only be up to 100% of the daily contract demand under the release for storage withdrawals or injections, as applicable
- Call/put option must be available to releasing shipper at least until 8:00 AM Central Time on the weekday prior to gas flow
Posting Requirements for AMAs

• Although exempt from bidding, *bona fide* AMAs must be posted on pipeline websites

• The postings must identify the release as being pursuant to an AMA and identify the asset manager

• The posting must specify the applicable put/call obligation
Flexibility in AMAs

• Capacity released subject to AMA becomes the Asset Manager’s to use as it chooses, subject to the put/call obligation

• Even when the put/call option is exercised by the releasing shipper, the Asset Manager may supply gas by whatever means it chooses

• The Releasing Shipper is not required to exercise its put/call option
Flexibility in AMAs (cont’d)

• FERC also granted a limited exception to its buy-sell prohibition to enable asset managers to buy from or sell to third parties at the direction of the releasing shipper

• Profit sharing
  ▪ Does not trigger FERC’s capacity release rate cap

• Today watch for:
  ▪ Cross border AMAs
  ▪ Novating supply agreements; entering into new supply agreements
Section 311 Interstate Capacity
Negotiating Terms

• 311 – Service agreements for 311 service are not required to be filed with FERC
  ▪ But the terms must be consistent with the pipeline’s Operating Statement (or the Operating Statement must be amended to conform)

• Intrastate – No regulation by FERC
  ▪ Rates and services not always regulated by states; more flexibility but less regulatory rights depending on the state
Jurisdictional Warranties

• 311 and intrastate pipeline might require warranties regarding the source and/or use of the gas

• 311 example:
  ▪ “Shipper represents and warrants … that the transportation of gas hereunder is "on behalf of" any interstate pipeline or any local distribution company served by an interstate pipeline …”

• Intrastate example:
  ▪ “Shipper represents and warrants … will have been produced in the [state] and shall be Gas which has not been and shall not be used, consumed or transported in another state, or commingled at any point, either upstream or downstream, with other Gas which is or may be sold, consumed, transported, exchanged or otherwise utilized in interstate commerce in any manner which [would subject the gas to FERC jurisdiction].”
Thank You!

Questions?
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