

FERC Establishes New Restrictions on Non-Jurisdictional Pipelines.

Invites Case-by Case Applications at Least for Every Buy-Sell Transaction and Maybe More. Restrictions and Invitation Apply to NGPA 311 Intrastate Pipelines and Hinshaw Pipelines and Probably LDCs Holding Blanket Transportation Certificates.

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In an order responding to a request for approval of a transaction between Arizona Public Service Company (APS) and Sequent Energy Management, L.P. (Sequent), *Arizona Public Service Co.*, 132 FERC ¶ 61,064 (2010), FERC expanded its prohibitions on buy-sell transactions to include not only transportation on open access interstate pipelines, but also transportation by intrastate pipeline operating under Natural Gas Policy Act (NGPA) section 311 and by Hinshaw pipelines providing transportation under blanket certificates. While expanding its restrictions, FERC invited market participants to apply for case-specific approval of every buy-sell transaction. In fact, because of the breadth of the order, such transaction-specific requests may be needed for every assignment of transportation capacity on a section 311 intrastate pipeline or a Hinshaw. In addition, because Local Distribution Companies (LDCs) provide blanket certificate transportation services under the same authorization as Hinshaws, there is no reason to believe transportation on LDCs would receive any different treatment.

FERC stated in its order that the issue of whether buy-sells were prohibited on section 311 pipelines and Hinshaw pipelines had never come up before. Transportation services have been authorized on Hinshaws and LDCs since 1980.

Section 311 and Hinshaw Transportation

Section 311 of the NGPA permits FERC to authorize interstate and intrastate pipelines to transport natural gas to the interstate market (which it does on a blanket basis), and section 601(A)(ii) of the NGPA makes it clear that such transportation is not supposed to subject intrastate pipelines to Natural Gas Act (NGA) jurisdiction. Although the NGPA made no such provision for Hinshaw pipelines or LDCs to provide such transportation, as long ago as 1980, FERC created a limited jurisdiction blanket certificate under section 7 of the NGA to allow LDCs and Hinshaw pipelines to retain their non-jurisdictional status while also performing section 311-type transportation service. Section 284.224 of FERC's

regulations permits Hinshaw pipelines and LDCs served by interstate pipelines to engage in interstate transportation and storage transactions in the same manner as intrastate pipelines under section 311 of the NGPA, under the authority of section 7 of the NGA.

Buy-Sell Prohibition

In June 2009, FERC approved a settlement between its Office of Enforcement, Sequent and Sequent Energy Marketing, L.P. in which FERC described a prohibited buy-sell transaction as "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." In that case, Sequent neither admitted nor denied Enforcement staff's conclusions that the transactions violated the Commission's buy-sell prohibitions.

A year later, Sequent and APS sought FERC's prior approval of a transaction for the use of a Hinshaw storage facility. Under the Sequent-APS proposal, title to the gas was to pass from APS to Sequent at the Hinshaw storage facility. APS was to have the right to require Sequent to redeliver gas from a source of Sequent's choosing to APS at specified delivery points at the storage facility. Although Sequent was obligated to redeliver to APS, Sequent was to be able to exercise control over the gas while it was in storage, including keeping the gas in storage at a different storage facility or selling the gas to a third party. FERC found the transaction to be a prohibited buy-sell, but FERC also found there was good cause to waive the prohibition, at least for a year.

The Buy-Sell Prohibition Is Not Confined to Capacity Release Programs

FERC asserted that intrastate pipelines and Hinshaw pipeline companies were excluded from the capacity release requirements of Order No. 636 and that the prohibition on buy-sell transactions was adopted to protect capacity release programs for interstate pipelines. However, FERC asserted that the buy-sell prohibition together with the shipper-must-have title rule plays a larger role than only protecting capacity release programs. Rather, FERC said, "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.' 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

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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for the direct sale of capacity by the pipeline or for capacity release by firm shippers."

Invitation to Apply for Waivers

FERC's order confirms that section 311 and Hinshaw pipelines are not required to include capacity release provisions in their tariffs (by which FERC meant their Statements of Operating Conditions) and as FERC observed, "nor have any such pipelines done so." In the absence of generally applicable operating provisions that establish a transparent means of assuring that capacity is being allocated in a non-discriminatory manner, FERC offered to entertain requests on a case-by-case basis, an approach which hardly appears calculated to enhance efficiency in transactions in the intrastate, Hinshaw and LDC transportation market.

In a statement that appears to confuse buy-sell transactions with capacity releases more generally, FERC stated, "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. 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."

However, as there is a general lack of transparency in capacity assignment on section 311 and Hinshaw pipelines (and LDCs operating under blanket certificates), the Commission has no contemporaneous assurance that any release or assignment would satisfy its non-discrimination requirements even if it is not a buy-sell. As a result, the Commission's offer to consider buy-sells seems like it's only the first chapter. Should section 311 intrastate pipelines, Hinshaws and LDCs develop capacity release programs on their pipelines? Should shippers on these pipelines be looking for Commission approval of every release or assignment? Is a willing buyer and a willing seller a good enough reason for a buy-sell on section 311 intrastate pipelines, Hinshaws and LDCs? Could be a long summer and a longer autumn.

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