Deregulation of the Natural Gas Industry

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HOT TOPICS

"DEREGULATION OF THE NATURAL GAS INDUSTRY"

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1. BACKGROUND

Natural gas is a regulated industry both at the federal and state level.

The 1970s and 1980s were marked by periods of shortages and surpluses.

The push for deregulation of the natural gas industry began with the Natural Gas Wellhead Decontrol Act of 1989.

The Wellhead Decontrol Act allowed market forces to set the price for gas at the wellhead.

The remainder of the gas industry was not deregulated. Pipelines offered a "bundled" or regulated price to the end user.

The "bundled" price offered many services at one set rate. A "bundled" pipeline might offer gas supply, gathering, processing, compression, storage, interstate transportation, intrastate transportation and distribution to the end user for one set price.

The Federal Energy Regulatory Commission (FERC) issued Order No. 636 in April 1992 which deregulated the pipeline industry. ["Pipeline Service Obligations and Revisions to Regulations Governing Self Implementing Transportation; and Regulations of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 636, 57 Fed. Reg. 13,267 (April 16, 1992); III FERC Stats. & Regs. Preambles, P30,939 (April 8, 1992); order on reh'g, Order No. 636-A, 57 Fed. Reg. 36,128 (August 12, 1992), III FERC Stats. & Regs. Preambles P30,950 (August 3, 1992); order on reh'g, Order No. 636-B, 57 Fed. Reg. 57.911 (December 8, 1992), 61 FERC P61,272 (November27, 1992), appeal pending sub nom. Atlanta Gas Light Co., et al. v. FERC, No. 92-8782, (D.C. Cir.)

2. IMPACT OF DEREGULATION ON PIPELINES

Order No. 636 had two goals: to increase competition in the natural gas industry and to maintain reliable gas transportation service. Both goals were realized.

Order No. 636 forced the pipeline out of the merchant business, opened pipeline facilities and pipeline storage to third parties, and implemented capacity release programs.

Order No. 636 dramatically affected the pipeline industry: non discriminatory open access to the pipeline and storage, gas supply realignment settlements with former wholesale customers, capacity release program.

Pipelines must compete with marketers, brokers and aggregators.

Market hubs were created nationwide offering new services (parking, wheeling, peaking, balancing, loaning, storage) at competitive rates. Market centers need uniform tariff language and flexible services to be successful.

Natural gas became a commodity traded on the New York Mercantile Exchange. Futures, options and hedging are offered.

Pipelines also offer more flexible transportation services. Pipelines file for simplified rates finding that complex multi-tiered rate structures inhibit competition.

3. IMPACT OF DEREGULATION ON LOCAL DISTRIBUTION COMPANIES

Order No. 636 changed the responsibilities and risks of the local distribution companies (LDCs).

Historically, LDCs offered gas sales service; typically, they did not offer transportation, balancing, or storage services. Rates for sales service to industrial customers were set higher than the cost of service causing industrial customers to subsidize residential service.

LDCs could now assemble a portfolio of gas supplies tailored to their own needs rather than the "one size fits all" service.

Intense state commission oversight is directed toward LDC gas purchasing policies, market affiliate use, purchase gas adjustment filings, integrated resource planning, and incentive rates.

State commissions will also grapple with the issues of unbundling at the local distribution company level. Unbundling will begin with open access transportation and storage.

Local distribution companies must compete with marketers, brokers and aggregators who wish to ship gas on their facilities. Competitors are nibbling away at the LDC's historic customer base: hospitals, libraries, dry cleaners, schools... If the LDC customer base shrinks, the rates will increase for the remaining residential customers. In some areas, LDCs are teaming up with aggregators to better serve the customers.

The local distribution company has an obligation to serve, both core and non core customers. (A core customer -- residential customer -- is a low load, heat sensitive, no alternate fuel customer.) Their competitors do not have an obligation to serve. Will the state commissions remove this LDC obligation to serve?

The local distribution companies offer new services: open access transportation, elimination of minimum volume restrictions, removal of alternate fuel requirements, storage balancing and standby services, administrative services, financial services.

Some LDCs are also offering "rebundled" services; wrapping together released capacity with gas supply to serve larger end users, or "streaming" -- dedicating specific gas supplies to certain customers or markets.