Important pipeline decisions from FERC

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Shale development in Appalachia, including Ohio, is booming. As the land rush draws to a close, companies are turning their attention to the midstream phase of development, which will be essential to the long-term success of the region's Marcellus and Utica shale development. In addition to new processing and fractionation plants coming online, thousands of miles of pipeline infrastructure are being constructed. According to an article Columbus Business First, there are at least 133 pipeline projects planned or in progress in Ohio.

Of the infrastructure projects planned in Ohio, a number of them fall within the jurisdictional scope of the Federal Energy Regulatory Commission (FERC). Developments in FERC's regulation of pipelines ultimately impacts the integration of Ohio's oil and natural gas resources into national markets. As such, a few noteworthy FERC decisions from the past year involving shale development and/or pipeline regulatory issues are highlighted below:

1) FERC decision provides an attractive outlet for Marcellus and Utica production

On November 26, 2013, FERC ruled in favor of Rockies Express Pipeline LLC's (Rockies Express) Petition for a Declaratory Order that the "Most Favored Nations" rights of its Foundation and Anchor Shippers [1] will not be triggered by potential deals with other shippers for firm transportation which have (1) an east to west primary path, (2) a term of one year or longer, and (3) service in only one rate zone. Under certain circumstances, the Most Favored Nations clauses in the Foundation and Anchor Shipper agreements entitled them to the lowest negotiated reservation rate applicable to other firm transportation shippers.

By way of background, Rockies Express operates a 1,679-mile-long natural gas pipeline extending from Colorado and Wyoming to Monroe County, Ohio. Although originally built to transport natural gas from west to east, Rockies Express modified the line's service in 2011 to reverse the flow direction and provide for the east to west transport of natural gas. This modification reflected recent increases in Marcellus and Utica shale gas production. Anticipating that its Foundation and Anchor Shippers would seek to trigger the Most Favored Nations clauses in the event of such east to west flow, Rockies Express filed the petition described above with FERC.

In support of its petition, Rockies Express asserted that the Most Favored Nations clauses in the Foundation and Anchor Shipper agreements referred only to service across multiple rate zones in a west to east direction, as the pipeline was originally designed to flow. Thus, argued Rockies Express, east to west transactions within only one rate zone were not contemplated under the Foundation and Anchor Shipper agreements. FERC agreed with Rockies Express' interpretation of the agreements, and granted its petition.

FERC's decision now enables Rockies Express to enter into contracts providing for the transport of shale gas from east to west within the rate zone running from Ohio to Missouri without triggering a rate reduction for its Foundation and Anchor Shippers. The ability for Rockies Express' to enter into such transactions will provide a good outlet for Marcellus and Utica production to Midwestern markets.

2) FERC authorizes information sharing by gas pipelines and electric utilities

On November 15, 2013, FERC issued a final rule allowing interstate natural gas pipelines and electric transmission line operators to voluntarily share non-public operational information to promote the reliability and integrity of their respective systems. To protect against undue discrimination and ensure that the shared information remains confidential, the rule also adopts a No-Conduit Rule, which prohibits recipients of the information from disclosing it to an affiliate or third party.

The decision is symbolic of the growing recognition of the increased reliance on natural gas as a fuel for electric generation, as well as the growing interdependence between the natural gas and electric industries. In particular, FERC highlighted the 2011 "Southwest Cold Weather Event" as one demonstrating "the crucial interaction between natural gas pipelines and electric transmission systems and the need for robust communication between these industry sectors to ensure that both systems operate safely and effectively for the benefit of their customers." The decision summed up the challenge caused by increased interdependence between the natural gas and electric industries as follows:

> [P]ipelines require advance nominations to ensure they have sufficient line pack and storage available to meet scheduled daily load of all their customers, including the gas-fired generators, which may constitute significant load for a pipeline and which generally rely on a just-in-time natural gas supply and pipeline delivery. While pipeline line pack and storage provide some operational flexibility to pipelines to accommodate load swings throughout the day, short term swings in demand by gas-fired electric generators resulting from redispatch by electric transmission operators may be difficult to manage, particularly during times of coincident peak loads on interstate natural gas pipelines and electric transmission systems, such as during unusual cold weather events when end-use customers may rely on both natural gas and electricity.

For Ohio, the combination of coal plant retirements and low-cost natural gas likely means a greater use of natural gas-fired base load generation within the PJM Interconnection.

3) FERC adopts regulations to provide optional automatic approval procedure for rate filings by intrastate and Hinshaw pipelines

On July 18, 2013, FERC issued an order establishing an optional automatic approval process for certain undisputed rate filings by intrastate and Hinshaw pipelines. Hinshaw pipelines are local distribution pipelines served by interstate pipelines that are not subject to FERC jurisdiction by reason of Section 1(c) of the Natural Gas Act. Specifically, a Hinshaw pipeline may engage in transportation in interstate commerce, or the sale in interstate commerce for resale, of natural gas received by that company within or at the boundary of a state, if all of the natural gas so received is ultimately consumed within such state. A Hinshaw pipeline may receive a certificate authorizing it to transport natural gas out of the state in which it is located without giving up its status as a Hinshaw pipeline. Still, FERC regulations require Hinshaw pipelines to file rates, charges, and a tariff with FERC.

The modified procedural requirements set forth in FERC's July 18 order provide an optional automatic approval process for rate filings by both Hinshaw pipelines and intrastate pipelines providing interstate service pursuant to Section 311 of the Natural Gas Policy Act of 1978. Under the modified procedure, an intrastate or Hinshaw pipeline's filing would automatically be approved by FERC without an order if the filing is not protested within a specified period of time after notice of the filing, or if any protests are resolved during a reconciliation period.

In its decision, FERC explained that the optional automatic approval process will provide an expedited and less burdensome method of processing filings by intrastate and Hinshaw pipelines that present few, if any, contested issues, thereby allowing FERC to devote more resources to other issues. In response to concerns that the process would reduce or eliminate staff review of the subject filings, or violate FERC's obligation to ensure fair and equitable rates of the pipelines, FERC explained that nothing in the decision reduces the review of filings or lessens the requirements for approval of filings, but only eliminates the need for a FERC order in uncontested filings.

4) FERC affirms jurisdiction over ethane, even if the ethane is used exclusively for feedstock purposes

On December 31, 2013, FERC confirmed its jurisdiction over the interstate pipeline transportation of purity liquid ethane, regardless of whether the ethane is intended for an energy or non-energy purpose. The case was one of first impression for FERC and arose when William Olefins Feedstock Pipelines, LLC (Williams) asked FERC to find that its proposed Williams Bayou Ethane Pipeline project (Ethane Pipeline) is outside of FERC's jurisdiction under the Interstate Commerce Act (ICA). 145 FERC ¶ 61,303.

Williams argued that the planned Ethane Pipeline would only deliver purity ethane to petrochemical plants and storage facilities. Therefore the ethane would only be used as a feedstock to produce ethylene and not as a fuel. Williams asked FERC to assess the purportedly "unique character" of the Ethane Pipeline by applying what Williams contended is FERC's traditional test: whether the product being transported serves in an energy-related, as opposed to a feedstock, function. According to Williams, purity ethane is similar to other non-energy products, such as anhydrous ammonia, over which FERC has disclaimed jurisdiction.

FERC disagreed with Williams' characterization of the applicable test. Instead, FERC stated that the test is whether the product being transported is a naturally-occurring hydrocarbon that is used, or can be used, for energy-related purposes as opposed to having only a non-fuel, feedstock function. FERC then determined that "it is unquestionable that ethane has a thermal heat content and has the capability of being burned and used for fuel or energy purposes . . . including being added to low-Btu natural gas to increase its heat content and being used in low-ethane propane for export for international use." FERC also noted the "future [energy] uses" of purity ethane. Finally, FERC stated that, in future cases, it "will not disclaim jurisdiction over interstate ethane transportation based on an applicant's assertion of the intended end-use of the ethane."

Footnote

1. An Anchor Shipper is a shipper that contracted for capacity of at least 200,000 Dth/day prior to Rockies Express' construction. A Foundation Shipper is a shipper that prior to Rockies Express' certification was awarded capacity of 500,000 Dth/Day or greater.

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