Overview

Background

On June 29, 2017, the Federal Energy Regulatory Commission (FERC) held a technical conference to discuss the state of liquidity and transparency in the physical natural gas markets. The FERC monitors price indices as part of its ongoing oversight of competitive energy and natural gas markets. The purpose of the conference was to solicit feedback and to develop a record regarding index strength and to discuss what if anything, the industry and/or the FERC could do to increase transparency and support greater robustness in natural gas price formation.

Reporting to price index developers who collect, aggregate, and publish spot natural gas price indices, is voluntary. For example, Platts and Natural Gas Intelligence (NGI) publish daily and monthly price indices based on information obtained on a voluntary basis by market participants about physical trades at various locations. The information is verified, compiled, and in some cases assessed, and a price representing the trading activity at each location is published.[1] These published index prices are used in the natural gas industry, where they may be used, among other things, to settle cashouts for imbalances or to determine penalties. State commissions may also use indices as benchmarks in reviewing the prudence of natural gas purchases by local distribution companies. Regional Transmission Organizations and Independent System Operators (RTOs/ISOs) may rely on natural gas indices to develop reference levels for market power mitigation.[2] However, with the abundance of shale gas, natural gas prices have declined and voluntary price reporting has declined.

Technical Conference

The all-day conference consisted of three panels and a presentation by FERC staff providing an overview of natural gas transactions reported in FERC Form No. 552 (Form 552) data.[3] The other panelists discussed the amount of transaction data being reported to index developers, the processes by which market participants provide data to index developers, the amount and quality of information provided by indices, and the confidence market participants currently have in price indices.

Acting Chairman LaFleur and Commissioner Honorable began the conference by emphasizing the need for robust indices because of the impact the indices have on setting just and reasonable rates. Both Commissioners stated the technical conference and the subsequent comments would create a record on which the FERC would act, therefore, both encouraged interested entities to submit comments on whether there are changes that need to be made to the FERC’s approach to natural gas indices.

FERC staff also provided a presentation on Form 552 data. Each May, market participants submit Form 552, and disclose physical natural gas bought or sold at a fixed price or physical basis, volumes traded and sold to provide transparency regarding physical natural gas transactions that settle off the index, and transactions that contribute or may contribute to natural gas indices. Market participants also disclose whether they report their physical transactions to index developers. In 2016, 1,234 market participants submitted Form 552 and only 134 of those participants indicated they reported their transactions to index developers.

Staff stated the two primary index developers referenced in FERC tariffs are Platts and NGI. Staff found that in 2016, the volume of fixed price transactions was as much as seven times smaller than the indices they created.
Staff also explained its findings as to liquidity of points found in 169 interstate natural gas pipeline tariffs. It found that 80 percent of those tariffs referenced one or more index. Staff found that 13 of 125 referenced indices were illiquid at some point between April 2016 and May 2017. They also observed that eight of those 13 points remain illiquid in June 2017. Staff also stated that as of May 2017, 75 different price point locations are used throughout the interstate natural gas pipeline and RTO/ISO tariffs. To this end staff observed that RTOs/ISOs may not specify a particular index but whatever index the RTO/ISO uses is subject to review by its market monitor.

The first panel was comprised of index developers, BP Energy Company’s Chief Executive Officer, and Professor Vince Kaminski, the Professor in Practice of Energy, Rice University. The panel examined the current trends in natural gas fixed-price and physical basis trading, the FERC standards to which index developers must comply, and whether there was a need for additional transparency.

The panelists were divided on the question of current trends in the natural gas fixed-price and physical basis trading. Orlando Alvarez, BP Energy Company’s President and CEO, lamented that BP was one of the only marketers to report its fixed-price deals to Platts and other index developers. He suggested that BP’s reporting increased the company’s risk because BP was often the only or one of a few entities reporting fixed-price deals at certain points. In support of his position Mr. Alvarez cited to a Platts report that analyzed Form 552 data and found that of the top 10 companies with the largest volume increase over the last year, nine out of 10 of those entities did not report their fixed-price deals to index developers. Consequently, Mr. Alvarez advocated for marketers to be required to report to index developers.

In contrast, the index developers - Euan Craik, Chief Executive Officer of Argus Media, Mark Callahan, Editorial Director for Platts North America, Tom Haywood, Editor, Natural Gas Week, Energy Intelligence, and Dexter Sties, Publisher, Natural Gas Intelligence - all agreed that although there had been a decline in fixed-price reporting, the markets remain very healthy. The index developers also suggested that they had seen an increase in late 2016/early 2017 in the reporting of day ahead fixed-price deals. The index developers did not agree with the FERC imposing mandatory reporting requirements.

All the panelists noted that liquidity in the markets had changed but they offered different reasons for the lack of liquidity. Some panelists pointed out that new infrastructure and new pipelines lowered volatility and thus, lowered, liquidity. Professor Kaminski agreed that the shale revolution and the resulting infrastructure build out has impacted liquidity. Another panelist commented that he expects liquidity to increase as exports to Mexico and liquefied natural gas exports increase.

All the panelists agreed that the standards the FERC created to develop a price index to be included in a FERC jurisdictional tariff remain appropriate and robust. Moreover, Platts cautioned the FERC from making any changes to these standards because the market has developed mechanisms and compliance safeguards based on the FERC’s standards.

Two panelists recommended the FERC look to other agencies for possible reporting tweaks. Professor Kaminski suggested the FERC look to the European Union’s Board of the International Organization of Securities Commission (IOSCO), who recently introduced categories of benchmarks.[4] The IOSCO Principles for Financial Benchmarks were published in July 2013 with the aim of creating an overarching framework of Principles for Benchmarks used in financial markets, covering governance and accountability as well as the quality and transparency of Benchmark design and methodologies.[5] One other panelist recommended the FERC look to the US Commodity Futures Trading Commission’s guidelines for index developers.

The panel ended with them addressing the need for additional transparency. Some panelists noted liquidity changes daily. For example, one panelist pointed out that Houston Ship Channel has seen less physical trading while physical trading at Katy has increased. Argus and other index developers explained that there is not a one size fits all for liquidity and that liquidity changes month-to-month. Platts added that liquidity was not the end all because of the 110 locations it tracks, some of those points only trade seasonally or periodically, therefore, a lack of liquidity at one or more of those points is not determinative. Professor Kaminski built on this observation by arguing the FERC should only impose a minimum liquidity threshold in jurisdictional tariffs because bilateral transactions are market based.

Rather than impose additional liquidity requirements, the index developers advocated for the FERC to revise its safe harbor provision. These panelists focused on potential enforcement risk. In its Policy Statement, the FERC gave industry participants safe harbor protection for good faith reporting of transactional data to entities that develop price indices. In particular, the FERC created a rebuttable presumption that companies and individuals that report trade data to index developers in accordance with FERC’s standards in good faith, will not be investigated or subjected to administrative penalties for inadvertent mistakes made in the course of reporting energy transaction information.[6] The panelists recommended the Commission clarify its safe harbor because there is confusion around reporting errors and whether the safe harbor imposes a requirement to report to more than one publisher and whether an entity must report daily and monthly trades.
The second panel consisted of representatives from natural gas trade associations, RTOs / ISOs, and energy companies. This panel examined the current industry uses of physical natural gas price indices and questioned whether the FERC should periodically reassess the liquidity of the indices referenced in FERC jurisdictional tariffs.

The panelists all expressed their confidence in the indices and the locational value of natural gas. Cheniere Energy’s Senior Vice President of Gas Supply commented that it has 2.2 to 2.4 Bcf of physical trades and expressed great confidence in the indices. He noted that Cheniere does not currently report to the index developers but that he expected it would begin reporting to them by the end of the year/early 2018. A representative from the Natural Gas Supply Representative explained that the indices reflect a robust market. The internal market monitor for ISO New England Inc. and the market monitor for the California ISO also expressed confidence in the indices.

Nonetheless, panelists offered suggestions to ensure the continued robustness of the indices. Kinder Morgan’s representative advocated for the FERC to review the US Securities and Exchange Commission’s white paper on liquidity which says a diverse set of players creates the liquidity. This diversity reference seemed to arise in response to the uncertainty around the agreement between Platts and the Intercontinental Exchange (ICE), where Platts granted ICE exclusive rights to use Platts’ North American physical natural gas benchmarks in the setting and clearing of natural gas derivatives contracts. Platts and ICE maintain the agreement will benefit market participants because such participants will be able to use ICE exchange transactions and ICE eConfirm, an electronic trade confirmation service, as a means of having their transactions data used in the Platts price assessment process. Kinder Morgan asked for clarity of how and when an index developer adds or deletes a point.

The California ISO raised concerns about the timing of indices. It noted the ongoing concerns regarding the perceived misalignment between the natural gas and electricity markets as it relates to natural gas indices and their use. Specifically, the California ISO representative said there is a disconnect between the time natural gas indices are published and when electric utilities and RTOs / ISOs need the data.

The second panel also expressed concerns around the safe harbor provision. Macquarie Energy’s representative stated the Commission needs to provide clarity around the Platts/ICE combination. He also suggested the FERC needs to clarify what it considers to be manipulation as it related to fixed price trading. To this end, he suggested the FERC make clear the safe harbor protects an entity from an enforcement action if the price reporter follows certain rules that the FERC would have to specify. The American Gas Association’s representative advocated for clarity and refinement of the safe harbor, which she said might increase her membership’s reporting to index developers.

The third and final panel addressed options to increase transparency and liquidity in natural gas indices. The panel was comprised of a cross-section of natural gas stakeholders.

The panelists offered a mix of opinions as to liquidity. Platts maintained there was sufficient transparency and that its partnership with ICE would increase transparency. Most panelists favored the present system of voluntary reporting to one or more index developers. All commented that increasing transparency, increases liquidity. One panelists offered the FERC should develop some minimum threshold over which an entity must report its fixed-price deals to an index developer. Tenaska Inc.’s representative, on the other hand, advocated for the FERC to encourage reporting. BP believes there should be a minimum level of liquidity at reported points and wants the FERC to mandate marketers to report their fixed-price data to index developers.

Joe Bowring, PJM’s market monitor expressed skepticism and bewilderment that the other panelists had such strong confidence in the indices. Specifically, he questioned the unwavering support in light of the lack of data at some points. He advocated for an independent review by Professor Kaminski and/or FERC staff to obtain evidence that the index prices are not biased. Notably, the other panelists pushed back on Mr. Bowring’s doubts explaining market participants regularly use the indices to contract, evidencing the ultimate confidence in the indices.

Like the other two panels, the third panel advocated for the Commission to clarify its safe harbor. Tenaska commented that the FERC’s audit process is burdensome and that the FERC should levelize its review to include those entities that do not report to index developers. Kinder Morgan also expressed concern that the majority of staff chairing the instant technical conference were from the FERC’s Office of Enforcement. He maintained the FERC’s audit staff must have a clear focus, share the audit focus with the target, explain how subpoenaed data from a non-target is used, and timely conduct and close an audit. The Interstate Natural Gas Association of America’s representative summed up the panelists’ positions by encouraging the FERC to offer fair and clear rules.

Comments are due July 31.

Next Steps 2017.

The FERC has several options for further action. It can accept the current state of reporting and take no further action; it can continue to monitor the existing voluntary reporting system; it can move towards mandatory reporting and/or centralized data collection; or encourage greater use of electronic platforms for trading, confirmation, and clearing. Regardless of its final action, in light of its lack of quorum, we anticipate the FERC will issue a draft document for further comment and/or process before it reaches a final policy pronouncement.
The technical conference panelists raised several issues that we will closely monitor as comments are filed, including,

- Should the safe harbor be changed or clarified?
- Should the FERC change its current voluntary reporting process and make reporting mandatory?
- Is additional transparency needed regarding natural gas index price assessments and the level of liquidity underlying each natural gas index published by index developers and should common minimum thresholds be defined?
- Do natural gas price indices sufficiently reflect the locational value of the natural gas to permit decision-making by those with an interest in the value of natural gas?
- Should FERC take action to foster more meaningful, reliable, and transparent price information in natural gas markets?
- Should the FERC consider exercising its authority under section 23(a)(1) through (3) of the Natural Gas Act (NGA) to require market participants to report price forming transactions to index developers?

Each of these issues raises questions that could impose additional burdens on market participants (both existing and those that have not been a part of this voluntary index reporting and use process). The outcome of this proceeding will not only impact natural gas pipelines but will likely impact state commissions and RTOs / ISOs.

For more information about the issues discussed in this advisory, please feel free to contact Monique Watson at +1 202 429 6483 and Marc Spitzer at +1 202 429 6479.


[3] FERC Form No. 552 collects data that utilize an index price, contribute to index price formation, or could contribute to index price formation. Transparency Provisions of Section 23 of the Natural Gas Act Order No. 704, FERC Stats. & Regs. ¶ 31,260 (2007) (Final Rule) (Order No. 704).


[5] Platts stated it is compliance with the IOSCO Principles. NGI, on the other hand, has not conducted an IOSCO review because it only operates in North America.


[7] Notably, in response to the Platts/ICE agreement, ICE will cease to exist as an independent index price developer. Therefore, the Kinder Morgan pipelines recently updated their tariffs to remove all references to ICE and just keep references to Natural Gas Intelligence.

[8] We note, the Commission’s last attempt at using NGA section 23(a) to promote transparency resulted in the United States Court of Appeals for the Fifth Circuit vacating the FERC’s orders as running afoul of NGA section 1(b), which exempts local distribution companies, producers, and gatherers from FERC’s jurisdiction. See Texas Pipeline Ass’n v. FERC, 661 F.2d 258 (5th Cir. 2011). The ruling vacated the FERC’s efforts to increase transparency by imposing certain reporting obligations on non-jurisdictional entities.