UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Developments in Natural Gas Index)
Liquidity and Transparency) Docket No. AD17-12-000

COMMENTS OF THE AMERICAN PUBLIC GAS ASSOCIATION

Pursuant to notices of the Federal Energy Regulatory Commission (FERC or Commission) and the Technical Conference held in this docket on June 29, 2017 (to which transcript (Tr.) references are cited herein), the American Public Gas Association (APGA) files these comments:

I. COMMUNICATIONS

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II. STATEMENT OF INTEREST

APGA is the national, non-profit association of publicly-owned natural gas distribution systems, with over 725 members in 36 states. Overall, there are approximately 1,000 publicly-owned systems in the United States. Publicly-owned gas systems are not-for-profit retail distribution entities that are owned by, and accountable to, the citizens they serve. They include municipal gas distribution systems, public utility districts, county districts, and other public agencies that have natural gas distribution facilities.

APGA members purchase interstate natural gas transportation services from pipelines at rates and under terms and conditions that are regulated by FERC, so they are of course subject to the utilization of price indices in those tariffs. Moreover, as explained below, APGA's members purchase nearly all of their gas under an index. Accordingly, APGA was among the first to bring to the Commission concerns about the accuracy of price indices created by publishers that take price surveys in the 1990's. As non-profit entities governed locally, APGA's members are strongly incented to resell the lowest priced gas reliably available that is correctly priced. As APGA's conference participant stated: "commodity costs … represent roughly 60% of our expenses for the gas system for the year so it is substantial so we want to make sure they are correct." Tr. 110. APGA participated at each of the junctures at which the Commission has attempted to encourage better transparency of price formation in wholesale energy markets. It also participated in the Technical Conference and makes these comments now.

III. EXECUTIVE SUMMARY: ALL IS NOT WELL IN THE UNIVERSE OF NATURAL GAS PRICE INDICES

Despite broad and deep support for the efficacy of the current natural gas marketplace proclaimed at the Technical Conference—and even pronounced confidence in the price indices themselves—the Commission's data and the conference discussion left no doubt that the way in which natural gas is priced today in the U.S. is deeply flawed. The comments of Joe Bowring, President, Monitoring Analytics, were on target: "I'm not quite sure whether this [is an] overwhelming vote of confidence in indices …. [The market participants] are confident most of the time except for when you really need to be confident when prices are going wild and at that point you use a multiple, you use something other than indices." Tr. at 210. Thus the Technical Conference illuminated that sophisticated market actors *do not rely on* indices to understand the market.

There is consensus that indices are flawed, there are "negative trends" (Tr. 35), and the entire system now "weakened" (Tr. 26). At the same time, there is consensus that index pricing is more popular than ever in contracting; conference participants attempted to explain that phenomenon at the conference. This dissonance is somewhat like <u>whistling in the dark</u>. We courageously accept indices even though we are quite fearful that they are wrong. APGA therefore does not agree with those who chose to believe that widespread dependence on indices equates with complete confidence in the price-setting system. The industry must do better. The Commission can lead the way.

APGA members utilize daily indices although most purchase most of their natural gas at a monthly index price that is set by price reporting agencies (PRAs).[1] Thus,

[1] Staff calculated that nearly half of the gas sold and purchased on a physical basis is tied to monthly indices. Tr. 16. Distributors including APGA members often baseload gas priced at a monthly index. The percentage of gas traded on a financial basis remains subject to speculation. Tr. 44-45 (ICE).

hundreds of communities throughout the United States are directly dependent upon the fairness, accuracy, and transparency of these price indices. The vast majority of these gas systems are relatively small purchasers of gas, and we believe that the vast majority purchase all of their gas using a natural gas index. They pay a cost-plus price under a contract with a marketer generally. "Cost" is deemed to be an index at a point reported by one of the index publishers. So APGA has a keen interest in this topic, as it has in the past when transparency was the threshold issue with indices years ago.

APGA members also are far flung: these communities are all over the U.S., so they are subject to most of the locational indices available. As Staff demonstrated, many of these indices are illiquid. These locations are often far away from the newly robust pricing locations. The functionality of price indices is a perennial topic at APGA meetings for these reasons. APGA's participant at the Technical Conference, Donnie Sharp, Senior Natural Gas Supply Coordinator for Huntsville Utilities, observed that many locational indices are thinly traded and not clearly reliable. Tr. 111. The Commission must address this by taking steps described herein to obtain greater levels of price reporting by buyers and sellers.

IV. COMMENTS

A. Flaws with Price Indices are Well Known

Staff reported at the Technical Conference that of the 1,234 entities that have ever submitted a Form 552, only 134 have indicated that they report to index publishers. Tr. 15. Cornerstone Research's latest annual report says that of the 711 Form 552 respondents this past year, only 15% reported transaction information to the price-index publishers for themselves or at least one affiliate. *Characteristics of U.S. Natural Gas*

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Transactions—Insights from FERC Form 552 Submissions. Worse, the ratio of index-priced gas to fixed-price gas has increased dramatically since 2009 from about 4 to 1 to 7.5 to 1. Tr. 16-17. Nevertheless, 78% of the total physical gas market in 2016 settled off next day or month indices (with the portion of gas sales settling off next day indices growing). Tr. 15. Participation in price reporting means liquidity. By any measure, liquidity is lower than it should be for consumers to have confidence in the index prices that they pay.

Natural Gas Intelligence published its analysis of Form 552 data and concluded that 12 of the top 20 companies ranked for total volumes of natural gas sold and purchased do not report to index publishers. J. Shelor, "Industry Asks FERC to Make Harbor Safer For NatGas Price Reporters," *Natural Gas Intelligence* (July 5, 2017). Similarly, Platts North America, S&P Global, reported that of the top ten traders that had the largest volume increase from 2015 to 2016 as portrayed in the Form 552 data, only one was a price reporter. Tr. at 40.

There is no question that PRAs are dealing with paltry data. It is less clear whether this is a result of indolent price reporters or a dearth of fixed price transactions on which to report. Argus Media claims that for the past three years, fixed price trades have been stable at around 15 percent of all volumes submitted on Form 552, but that is historically low.[2] Staff reported that there has been an 18% decline in fixed price quantities since 2009 and acknowledged this as a concern. Tr. 16; 20. Written comments in this proceeding may be more conclusive than the Technical Conference.

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[2] Statement of Argus Media, Docket No. AD17-12 (filed July 7, 2017).

If, in fact, the issue is a relative reduction in fixed price transactions, then there is little for FERC to do. On the other hand, if price reporters are just being diffident, there is a role for FERC to play.

B. FERC Should Revise, Restate, and Reissue a Policy Statement on Price Indices

1. APGA is Concerned About Index Illiquidity

Platt's Inside FERC is 24% illiquid, *i.e.,* 20 of 85 indices do not meet FERC's standard for liquidity. Staff further found that of all 125 indices used in pipeline tariffs were illiquid during the past year, 13 were illiquid.[3] No one questions Staff's objective conclusions. Further, *Natural Gas Intelligence* describes an isentropic decline in the amount of data received since 2008. Tr. 32-33. BP Energy Company has long cited an overall trend of lower physical liquidity across the board. BP's President and CEO repeatedly cited the current example that *Platts* relied on a mere 53,000 Dth/d reported to set winter month index price for TETCO-M-3 where a vast quantity of gas sold. *E.g.,* Tr. 39-40. Professor Kaminski opined that there are too many free riders in the market; many producers are struggling with low prices and are too busy to be bothered with price reporting. Tr. 36. Orlando Alvarez, President and CEO of BP Energy Company, described how he believes many other marketers view the issue: "price reporting it just introduces risk and so we will just you know, piggy-back you guys and take index. And that's what is happening more and more and more in this industry." Tr. 57.

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[3] Tr. 19. Staff states that its standard is "if an index fails both criteria on a rolling 90 day average for a daily or weekly index or 180 day average for a monthly index." Tr. 18.

This problem is so real that Platts regularly makes a "price assessment" at an illiquid point where it manufactures a price based on other, public data. Tr. at 211-212. In other words, in the absence of concrete data, the PRAs make their best guess.[4]

Not surprisingly, *Platts* has offered ideas to "make it more of an incentive to price report" essentially by threatening non-reporters with FERC audits. FERC should probably avoid the stick in favor of a carrot. Requiring an explanation on Form 552 may yield some insight about non-reporting. But harassment should be avoided.

2. The Safe Harbor for Reporting is Not Safe Enough

While the Commission is certainly free to try moral suasion to induce more price reporting as suggested by Professor Kaminsky, it must do more. The Technical Conference revealed the broadly held opinion that reporting to index publishers is negatively affected by concerns that literally a "fat finger error" could lead to an investigation.

Fourteen summers ago, the Commission heard that an obstacle to increased voluntary reporting is the concern that the Commission could take action against companies that make a mistake when reporting price data to index developers—in light of then discussed, but-yet-to-be-implemented, $1 million a day penalty authority. Many parties commented on the need for regulatory certainty and urged the Commission to adopt a safe harbor approach to good faith reporting. The outcome in 2003 was a Policy Statement with a "safe harbor" for good faith reporting. Price reporters were

[4] *Platt's Inside FERC Gas Market Report* for January 2017 listed 7 locations "assessed by Platts and deviated from the standard volume weighted average methodology in" ways described in the publication, including using "historical bidweek price differentials."

advised by the Commission to adopt several minimum standards for reporting transaction data to index developers. The Commission concluded:

> For data providers that can demonstrate that they have adopted and followed the [minimum] standards discussed above, the Commission will presume that transaction data submitted to index developers is accurate and timely and submitted in good faith. The Commission does not intend to prosecute and/or penalize parties for inadvertent errors in reporting, nor will it refer such issues to other agencies having jurisdiction. [5]

In its next breath, though, the Commission reminded participants that this "good faith reporting presumption is a rebuttable presumption, and actions taken to manipulate, misinform, or mislead index developers and/or market participants will not be permitted" and will be subject to enforcement actions.[6] This embrace of a safe harbor was viewed as lukewarm by many potential price reporters, especially in the context of a growing number of enforcement actions at the time.

The Commission should now issue a revised and updated policy statement that puts its enforcement actions into context. Certainly, those who report false trades with an intent to manipulate a price should be punished. But those consumers—distributors and end users—who make a good faith effort to report should not be punished if they make a mistake. The Commission should state that plainly and unequivocally.

The PRAs have become more sophisticated in the years since the policy was adopted. The Commission's concern with "errors" largely is accounted for by the PRAs themselves. The Commission should walk back its concern on errors expanded upon in the 2003 Policy Statement and replace it with a new discussion that reduces the burden

[5] 104 FERC ¶ 61,121 at P 37.

[6] *Id.* at P 38.

on the price reporting entity. A simple good faith standard should govern errors. Errors can be detected and remediated by the PRAs.

Given that the Commission has stated that it would "not penalize such parties for inadvertent errors in reporting"[7] a long while ago, it is somewhat perplexing that entities resist participation out of fear of enforcement. Given the compliance routines with which natural gas market participants already comply, cost or bother cannot be the main reason for the lack of participation. The reasons may extend to simple distrust of the government[8] and *perception* of a too great a risk of governmental entanglement. That perception may not accord with reality.[9] The Commission can address that perception in a revised and restated policy that enunciates the public interest need for more price reporting to make the market robust and more reliable. A timely transparent reassurance by the Commission may reinvigorate participation with PRAs.

The Commission could elevate aspects of a Policy Statement to a regulation. This would give the greatest level of comfort possible to industry participants as the Commission must abide by its own regulations. Further, elevating this matter to a proposed rulemaking proceeding would communicate the seriousness of the issues with inadequate price index reporting and price formation.

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7 Price Discovery in Natural Gas and Electric Markets, 112 FERC ¶ 61,040 at P 1 (2005).

8 Distrust of and a lack of confidence in institutions—especially the federal government—is a growing issue for society. *See* Arlie Russell Hochschild, *Strangers in the Their Own Land: Anger and Mourning on the American Right* at 102 (2016) ("the Tea Party feared, disdained, and wanted to diminish the federal government").

9 Tr. 202 (Moffatt: "And I agree, I think it's more a fear of regulation than actual regulation but nevertheless it hits.").

Finally, the Commission must follow up its action with periodic reports on the state of the natural gas price indices. The more light shed on this topic, the better. Staff's periodic state of the market reports to the Commission should include a section on index price liquidity trends.

3. Create a Separate Reporting Category for Monthly Deals for Safe Harbor

APGA favors changing the rules to induce more reporting of monthly fixed priced transactions. As noted, most of APGA members purchase most of their gas under these indices, and, when they do so, they are purchases fixed baseload quantities. J.C. Kneale, vice president of North American Natural Gas, Power & NGL Markets for the Intercontinental Exchange, suggested some companies would be willing to report monthly but do not want to bother with "more onerous" daily reporting. Indeed, those daily prices are for much different loads than baseloads that are priced monthly. There is a distinction between these two types of supply that supports separate rules for the associated index.

The Policy Statement states that companies that report fixed price deals to PRAs, must submit all their reportable deals. The Commission should modify this policy to encourage the current standard but also allow a reporting entity to elect to report just its monthly transactions and not be bound to submit daily transactions as well. This could boost the liquidity of monthly indices upon which APGA members generally rely. There appeared to have been a consensus on this proposal at the Technical Conference. Tr. 205 ("there are customers out there that would report monthly that don't want to take the effort to report daily.").

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C. Price Data Must Remain Accessible

It is fair to say that the cost of subscriptions to price indices annoys most APGA members somewhat. Nevertheless, the price is competitive. APGA is concerned that the price index business remain competitive, else the price of access will increase dramatically. The Commission must consider this in setting policy.

D. FERC Must Remain Vigilant for Market Manipulation

APGA supports FERC's enforcement efforts. Price manipulation is a real and present danger. Just within the past year, FERC Enforcement found that National Energy & Trade fraudulently sold physical basis at Henry Hub during the April 2014 bid week in order to boost the value of its financial exposure to a major index for U.S. natural gas prices.[10]

The Technical Conference illuminated how a few large traders make up a high portion of the trades at many points. Not surprisingly, those very large traders are cognizant of the potential that they will be accused of manipulation in light of this concentration that everyone acknowledges the Form 552 data demonstrates.

Although it might go without saying, APGA as representative of smaller economic entities that usually are "price takers" and not market makers, emphatically appreciates and supports the market monitoring conducted by the Commission.

[10] *National Energy & Trade, L.P.,* 156 FERC ¶ 61,154 (2016)*; In re David Silva,* 156 FERC ¶ 61,155 (2016).

V. CONCLUSION

Nearly half the natural gas consumed in the physical market in the U.S. is priced at a monthly index that is derived from reports on a mere 9% of the total purchases and sales. Tr. 16. Action is required. APGA respectfully requests that the Commission continue its vigilance regarding the price index problem and issue a revised policy statement to account for current problems, including the lack of price reporting to PRAs.

Respectfully submitted,

AMERICAN PUBLIC GAS ASSOCIATION

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