ATTACHMENT "D"

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Price Discovery in Natural Gas and Electric Markets	)	**Docket No. PL03-3-000**
Natural Gas Price Formation	)	**Docket No. AD03-7-000**

COMMENTS ON THE STAFF REPORT ON NATURAL GAS AND ELECTRICITY PRICE INDICES OF

THE NATURAL GAS SUPPLY ASSOCIATION

Pursuant to the procedures established in a Federal Energy Regulatory Commission ("Commission" or "FERC") Notice of Conference on Market Liquidity, Energy Price Discovery, and Natural Gas and Electricity Indices in the above-captioned proceeding, published May 14, 2004, the Natural Gas Supply Association ("NGSA") hereby submits comments on the natural gas issues raised in the May 5, 2004, FERC Staff Report on Natural Gas and Electricity Price Indices ("Staff Report").

I.

Introduction And Executive Summary

The NGSA represents integrated and independent companies that produce and market natural gas in the United States. Established in 1965, NGSA encourages expanded use of natural gas and supports regulatory and legislative actions that foster competitive markets. According to the Staff Report, natural gas producers are leading the way in terms of reporting all day-ahead and bid-week natural gas transactions[1] consistent with FERC's policy statement on energy price reporting ("Policy Statement")[2].

Based on the public record established since the issuance of the Policy Statement, NGSA supports a Commission policy option of continuing to focus attention on the price reporting and transparency needs of the natural gas marketplace. As the Commission's survey makes clear, more than 90 percent of the respondents believe the glass is more than half full in terms of their confidence in the indices – with more than two-thirds of the respondents characterizing their confidence level as "7" or higher on a scale of 1-10[3]. NGSA believes there is certainly nothing in the record that would justify the commission's introduction of mandatory reporting.

The Commission's Policy Statement is already having some beneficial effects in terms of enhancing market transparency and confidence, and it will continue to do so as further upgrades evolve and work their way into the process for wholesale natural gas transactions. As a result, U.S. customers will continue to be served in the most efficient way possible by the most sophisticated, competitive and dynamic natural gas market in the world[4].

As the Commission continues to review the price-reporting process, we believe it will be increasingly important to evaluate progress based on a standard that is more volume-

[1] *See* U.S. FERC "Report on Natural Gas and Electricity Price Indices," May 5, 2004, Figure 4 at 28.

[2] July 24, 2003.

[3] *See* Appendix, U.S. FERC "Report on Natural Gas and Electricity Price Indices," May 5, 2004, Question 8 at 106-113.

[4] *See* "Balancing Natural Gas Policy – Fueling the Demands of a Growing Economy, Vol. 1," National Petroleum Council, Sept. 25, 2003, at 60. "The North American natural gas market is the largest and most liquid gas market in the world, with hundreds of suppliers and thousands of major consumers including LDCs, industrials and power generators."

weighted, with somewhat less significance placed on capturing increasing numbers of small individual transactions. Going forward, such regular volume-weighted analyses will be much more meaningful to users of the market data than analyses based numbers of individual transactions reported. Clearly, there will continue to be low-volume price points where the number of deals reported takes on greater importance, but this kind of transparency will only help the market determine the continuing viability of any individual pricing point. Overall, it will be the percentage and absolute level of volumes accurately reported that will instill even greater confidence in the market. We concur with FERC Staff that at least this much is achievable, as well as with its finding that there will always be a few market participants who will continue to demand Commission time and resources for further, but limited, benefits[5].

The Commission has demonstrated strong leadership on price index issues, which is clearly making a difference in terms of enhanced market transparency. Our comments are intended to support and further our common aims.

II.

Background

During the past two decades, Congress and the Commission have allowed the natural gas industry to usher in a new era, governed by a fundamentally different regulatory framework. This evolution has seen the industry move from one of strict command and control regulations to a more free-market environment, with regulations still in place to protect consumers from the exercise of market power where natural monopolies exist. The repeal of wellhead price controls, the resulting commoditization of natural gas, the reforms that opened up the interstate grid and the increased number of industry participants, taken together, have

[5] Oral presentation of FERC's Steve Harvey, Office of Market Oversight and Investigation, May 5, 2004.

resulted in a sea change in the natural gas landscape since the days of area rate cases and the *Phillips*[6] decision.

In any industry, transitions of this magnitude rarely occur without bumps along the way, and to our collective credit, the Commission along with industry have worked together to find solutions. While there have been some challenges, they continue to be addressed, ensuring the accurate reporting of price data.

Platts has been publishing price data for more than 15 years, *Natural Gas Week* for more than 17 years and *NGI* for nearly 20 years. These companies have been significant participants in the evolutions of the last two decades and should be allowed to continue applying their experience and knowledge to improve the quality of their price reporting.

III.

Initial Progress

When it comes to implementation of the Commission's existing Policy Statement on price reporting, as well as overall market transparency, there are many possible measures of success. Perhaps the best measurement would be one that focuses primarily on the volumes captured and reflected by the indices. According to the Staff Report and the index publishers, almost all of the top natural gas suppliers are reporting their day-ahead and monthly bid-week transactions, with data on their volumes-sold available to the public as a quarterly benchmark. This allows market participants, as well as the Commission, to more properly estimate the value of the indices as a reflection of the ever-changing dynamics of market-based pricing.

There are other methods that also have been submitted for the Commission's consideration. However, looking only at the measurements provided by the FERC Staff in its report, as well as the specific survey results on which that measure was based, there is sufficient

[6] *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

evidence of progress to support the continuation of the Commission's current price-reporting policies.

For example, Staff concluded that the amount of transaction data reported to natural gas and electricity price index developers "has been improving compared with late 2002." In addition, "the quality of reporting to price index developers has improved significantly over the past year." And, "index developers have taken significant steps to conform to the standards of the Policy Statement." Finally, as a further indication of market confidence beyond the individual respondent rankings, "survey respondents cite a high level of dependence on natural gas indices as price references in contracts."[7]

Further, we would like to draw the Commission's attention to another key staff summary: "Most comments received in this docket indicate that the Commission's Policy Statement has made a positive contribution to the number of market participants reporting trade data, the quality control over the data reported, and increased transparency of information in price indices for natural gas and electricity."[8] The Commission needs to look no further for reasons to justify its reliance on the Policy Statement going forward.

Nonetheless, the survey responses themselves provide further support for this course of action. The most compelling evidence from the Commission's survey is that 90 percent of the respondents - including all of the responding producers and industrial customers - use the indices in physical transactions. In terms of confidence, more than 90 percent of the respondents believe the glass is more than half full in terms of their confidence in the indices – with more than two-thirds of the respondents characterizing their confidence level as "7" or

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[7] *See* U.S. FERC "Report on Natural Gas and Electricity Price Indices," May 5, 2004, at 2.
[8] *Id.* at 3.

higher on a scale of 1-10[9]. NGSA anticipates that the average confidence level reported would turn out to be even higher if the Commission should choose to also focus on the more liquid and heavily relied-upon index locations in future assessments, instead of simply an overall average that includes thinly traded price points.

NGSA notes that price reporting also tends to be a function of company size, which is likely to be an ongoing challenge under even the best of circumstances. In all survey categories, the average size of those reporting all appropriate transactions is greater than the average size of those not reporting. As cited by the Market Price Reporting Action Committee in its recent submission[10], this likely leads to reporting from large suppliers and not their smaller counter-parties -- *which also indicates that the existing indices are actually capturing a larger* percentage of the whole than implied by the commission survey.

IV.

Further Enhancements

As FERC Staff correctly noted in its report on the survey, "further improvements in natural gas and electricity price discovery processes are clearly possible."[11] From NGSA's perspective, we support greater transparency in the aggregate reporting of the natural gas index developers, particularly with regard to volumes, which will continue to boost confidence among market participants. Moreover, the Commission should continue to encourage utilities and small users to begin reporting, or expand their existing reporting, to the publishers. It will be important

[9] *See* Appendix, U.S. FERC "Report on Natural Gas and Electricity Price Indices," May 5, 2004, Question 8 at 106-113.

[10] May 21, 2004.

[11] *See* U.S. FERC "Report on Natural Gas and Electricity Price Indices," May 5, 2004, at 3.

going forward to better understand why those who choose not to report natural gas transactions make that choice.

We concur with FERC Staff that further transparency enhancements can be achieved, but also with its finding that there will always be a few market participants who will continue to demand Commission time and resources for further, but limited, benefits. This is particularly true in light of the FERC Staff finding that "the crisis of confidence in price indices stems in part from liquidity problems in energy markets, rather than being the cause of such problems."[12]

Liquidity is a direct result of market-driven activity -- activity that can be facilitated by appropriate federal regulation or frustrated by prescriptive and overly intrusive rule-making. Fluctuations in such market activity do not necessarily represent a problem, however, nor is there any objective threshold for a lack of market liquidity. With regard to natural gas markets, NGSA believes there continues to be many willing buyers and sellers, resulting in an adequate level of liquidity.

We continue to welcome and encourage the Commission's effective use of its oversight and direction to focus industry action on the issue of publicly reporting transactions and, most importantly in the public interest, overseeing the behavior of participants in the wholesale natural gas markets.

[12] *Id.* at 4.

V.

Conclusion

Based on the public record established since the issuance of FERC's Policy Statement on price reporting in wholesale natural gas markets, NGSA believes there is sufficient evidence to support a Commission policy of continuing to focus attention on the price reporting and transparency needs of the natural gas marketplace. On its own, the Staff Report contains sufficient justification for this option. Conversely, NGSA believes there is nothing in the record that would justify the commission's introduction of mandatory reporting.

As the Commission continues to review this process, we believe it will be increasingly important to evaluate progress based on a standard that is more volume-weighted, with somewhat less significance placed on capturing increasing numbers of individual transactions. Clearly, there will continue to be low-volume price points where the number of deals reported takes on greater importance. However, overall, it will be the percentage and absolute levels of volumes reported that will continue to push market confidence even higher. Such enhancements can still be achieved, but beyond this point there may soon be diminished returns from the Commission's investment of further time and resources.

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Respectfully submitted,

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