Innovative Rates

Clients seeking market-based rates need not apply for market-based rates for all of its natural gas transmission services. A novel approach is to submit two different types of applications to FERC depending on the degree of competition at various points on the applicant’s pipeline system. First, an application for market-based rates may be submitted for the major receipt and delivery points on the pipeline system where a high degree of competition and a lack of market power can be demonstrated.

For the remaining captive receipt and delivery points on the pipeline system (where customers have no good transportation alternatives), a second application could be filed asking for flexible value-based short-term pricing as promoted by Order 637.

Remaining captive customers will retain the right to purchase pipeline capacity from the pipeline under a long-term cost-based recourse rate under this analysis. For customers choosing short-term service that will not commit to long-term service, more flexible value-based short-term pricing is appropriate, particularly when additional revenues from short-term services are shared with long-term recourse rate customers.

Since Order No. 636, the industry has witnessed a dramatic growth in the use of marketers to sell gas, arrange transportation, or provide both services to LDCs, industrials, end users, and electric generators. The growth of downstream markets has affected the transportation market as well. Shippers now have the choice of buying gas in upstream markets and transporting that gas to their downstream delivery points or purchasing gas in downstream markets. A more competitive pipeline transportation market has also developed with shippers able to choose between alternative means of acquiring pipeline capacity. Shippers can choose either short- or long-term services from the pipeline or acquire capacity from other shippers through the capacity release mechanism. Contract renegotiation, both as to coverage and term, has increased the risks for pipelines that may have greater difficulty reselling capacity. Today pipelines face greater risks in terms of long-term contract coverage, a greater reliance on short term contracts, and discounted contracts.

Commission policy has allowed cost shifts associated with discounting and decontracting to be recovered from the pipeline’s long-term captive rate customers, although the Commission has expressed concern over the level of these cost shifts and has tried to address these specific problems in Order No. 637. In Order No. 637, the Commission stated that peak/off-peak rates could allow pipelines to increase revenue recovery from peak period, short-term shippers. Such increased cost recovery from peak short-term services would lower the level of costs that need to be recovered from long-term customers and minimize the cost shifting that occurred with off-peak discounting. By reducing the rates in the off-peak periods, peak/off-peak rates could reduce discounting and reliance on discount adjustments. The Commission clearly recognized that peak/off-peak rates would better reflect the value of capacity during peak and off-peak periods, again reducing the need for discount adjustments.

Innovative rate proposals have three basic benefits. First, to the extent that a pipeline is allowed to charge short-term value-based rates, as Commission Order No. 637 allows, the pipeline may see an increase in the total amount of revenue recovery from short-term value-based services. The pipeline may be able to charge higher short-term rates that recover more of its fixed costs on higher demand days than would be possible if the short-term rates remain equivalent to the long-term recourse rates. Natural gas pipeline companies are very capital intensive and, given the large fixed costs of pipeline infrastructure investments, it is unlikely that pipeline company management will make investments in pipeline facilities if they are unable to recover some of their fixed costs in longer-term firm contracts. This proposal is expected to increase the recovery of fixed costs from firm contracts. Second, to the extent that potentially higher short-term value-based rates contribute to the overall revenue requirement of the pipeline, these higher revenues will lower the pipeline’s revenue requirement from its long-term firm shippers, and thus lessen the cost recovery imposed on those long-term firm customers. The third benefit is that to the extent that short-term rates are determined by market conditions, higher rates for short-term services will provide more efficient price signals on the short-term value of the pipeline’s capacity. Pipelines and their customers carefully monitor the capacity release and short-term markets for daily price information about capacity. To the extent that prices rise in these daily markets, it will encourage end users and LDCs to sign up for longer-term firm contracts instead of speculating that they can meet their peak demand requirements through a combination of IT, capacity release, and short-term services. The Commission clearly recognizes that, in competitive markets, price efficiently allocates capacity to customers that value it the most and this should be true for short-term pipeline service.