

DATE: February 3, 1998

TO: Joel Greene

FROM: Jerry Hahn

copy to: **GISB Executive Committee**

**Re: “Lesser of Rule”**

This is responsive to your memo dated January 23, 1998. I hope our letter writing isn't taking on the appearances of a letter-writing contest! My intent, as yours, is to keep the entire E.C. informed as much as possible so we can efficiently bring about resolution of my concern. Thank you for the list of questions and concerns.

The responsibility of GISB, and most specifically the E.C., is to hear concerns, problems and/or needs of the five segments of the industry. It exists to improve the competitiveness of natural gas and requires concessions by each segment at times to achieve the greater objective. My objective is not to “water down,” but is to recognize that the “Lesser of Rule” is not a perfect solution. I believe most people who were active in the Intraday TF recognize why something like the Lesser of Rule is necessary. Producer reps understand that a rule is needed, but also recognize the existing rule allows the possibility of “gamesmanship and unbridled discretion” by parties downstream of the well. In other words, all Shippers, Buyers and Sellers could cause a decrease without any agreement from producer/operators that a flow change is reasonable/acceptable/possible. I have trusted that it would not be used in that manner and ask you for similar consideration given the validity of the issue.

You will recall that Bob Wallenhorst continued to seek support for an alternative to the “Lesser of Rule” in the Task Force meetings. At the January 8 and 9 E.C. meetings, he again conveyed the merit of unanimous agreement before flow changes. In other words, if more and clearer communication is what we all want, we should have adopted Bob's alternative language. That did not happen and, therefore, the producing segment's concerns were not addressed. That led to the last vote before I left the meeting which did not muster two affirmative votes from the producing segment.

I agree with your opinion that we need meaningful dialogue on this issue at the next EC meeting. To that end, I offer you the following in reply to questions and assertions in your January 23, 1998 memo to me:

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Paragraph 1, pg. 1, assertion (1) the price we pay for gas, etc. . . The volume profile of the production area and the market area have been and will continue to be very different! Producers generally need to produce at steady-state. Our supply responsibilities have traditionally been steady-state (firm) in order to provide maximum reliability of natural gas supply.

Market area (demand) requires flow variability based on consumption characteristics. Of course, consumption is affected by temperature, demographics and other reasons I may not be aware of. The point is that producers have always fed this variable demand with steady-state production. Pipelines and storage provided the “buffer” between the two profiles.

I believe all 5 producer E.C.members recognize the role that Intraday nominations will play in supporting the growth of natural gas demand in N. America. Please remember that the Producer segment originally championed the Intraday Nomination effort which has produced these standards. However, the “Lesser of Rule” as a standard was born in GISB and, therefore, does not reflect past relationships in the industry.

Paragraph 1, pg.1, assertion(3) your proposal creates, etc. . . As stated previously, I trust that all participants will make a good faith effort to communicate with parties so that the use of the “Lesser of Rule” is kept at a minimum. That is the spirit in which the Intraday Nomination recommendations came to the E.C.

Numbered paragraph 1. I ask you to re-read paragraph 2 of my January 19, 1998 letter because it demonstrates my concern. To expand a bit, however, I think the Intraday 2 nomination cycle is where the problem will occur. That is because scheduling and flow changes are done at 9:00 p.m., Central Clock Time, when many points are not currently accessible other than by boat or helicopter. To do so requires much greater risk than during daylight hours.

Intraday 2 cycle was needed by LDC’s and market area end-users, as I recall, for use in nominating gas out of storage. To the extent the Intraday 2 cycle is used that way only, my modification should cause no change in the effect of the “Lesser of Rule.” If, however, Intraday 2 was used for reducing gas at sourcing points in the production area which are not accessible at night, we would have the problem I envision. I am hopeful that the number of occurrences will be relatively small, but the impact is significant when it happens because the operator’s choice is between an imbalance or risking people’s welfare making the physical change.

Numbered paragraph 2. The 80-20 split is an estimate based on a few discussions with people who were willing to offer an educated guess. Most major producers/shippers rely on hubs, pools and other large volume points to manage volume. I believe that ripple-back effects of the Lesser of Rule can be managed at such points, but I do not think this works for all transactions all the

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time. GISB simply should not pass standards that, even in a small percent of the time, cause a choice between two unacceptable alternatives. I also feel GISB must represent smaller producers that don't participate in GISB when such considerations are being made by us. Clearly the small producer can find himself at risk through use of the Lesser of Rule since most sales are at the wellhead.

Numbered paragraph 3. Taken to the extreme, 24-hour/day control could mean production sources matching demand exactly and that isn't GISB's objective. There are existing mechanisms to accommodate fluctuating demand without physical wellhead controls. Major producers have been moving to greater control by operation of these alternate means as well as installation of remote controls, as you suggest. My 80-20 estimate reflects that fact. In some instances however, it would not be reasonable or cost-effective to put every source on 24-hour flow control.

Numbered paragraph 4. I must take exception to your first sentence and statement that, a particular shipper transaction . . . cannot usually be traced . . .! They are now and that is the reason GISB is vexed with the title transfer tracking challenge. Sellers of gas, as well as purchasers of gas, find out after the fact that something did not flow or was different than originally agreed upon and, in many cases, this has financial consequences. The objective of the TTT effort is to bring accountability to everyone in the transaction chain. As to your second sentence, I cannot be sure every producer on every TSP will have the ability to take swings at alternate locations as you suggest.

Numbered paragraph 5. The price of natural gas is set at objective-standard market points such as hubs ,pools and Index points around the country. Remote locations receive a lower price relative to their objective-standard point (not higher) which reflects the additional cost to move the gas to such point.

Numbered paragraph 6. As I indicated in the opening paragraph of this memo, the Lesser of Rule gives you ,the enduser, the greatest opportunity for broad and unmonitored discretion over use of the Lesser of Rule. It seems ironic that the end-user representatives on the E.C. are concerned about my motives when other segments of the E.C. aren't exhibiting similar concerns about enduser motives. However, in answer to your question on accountability, I think a point operator finding itself with a Request for Confirmation at an inaccessible point that it had not agreed to could respond verbally to the downstream operator which would echo " no change " up and down the transaction chain. If GISB electronic standards were being used, perhaps an additional code could be added to the "Reduction Reason" data element to signal " no change from scheduled quantity possible". In either case , just as the E.C. responded to enduser desires that led to the new standard 1.3.22.iv, a similar reporting arrangement may be necessary if the E.C. finds it beneficial.

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Joel, as you stated during the January E.C. meeting, you come to the E.C. table to discuss your issues and get help from those at the table that may be more knowledgeable on a given issue. I don't pretend to have answers to all questions you may have, but I firmly believe this is a valid concern that the E.C. must consider.

I have an alternative solution to the one cited in my letter to the E.C. dated 1-19-98. Hopefully it will be a help also in our further discussions.

A new standard 1.3.22.v that says " In the event the operator of a gas transaction point or other flow control point that affects flow at a gas transaction point cannot make flow changes called for by action of standard 1.3.22.iii because the operator would have to risk the safety of people to make the requested flow changes, the previously scheduled quantity shall be the new confirmed quantity until such time as the operator is able to safely implement a flow change. The determination of these points shall be made by the parties with operating responsibilities affecting such points."

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