

Index-Based Capacity Release – Bidding and Capacity Award Considerations
WGQ BPS Meeting / October 9-10, 2007

Objective:

Design a bidding and allocation process consistent with existing NAESB WGQ Standards; adding and modifying Standards where necessary to provide clarity to the capacity release facilitator, e.g. TSP, to process bids and to allocate capacity.

Assumptions:

- 1) WGQ Standard 5.3.26 is modified as proposed during the September 9-10 BPS meeting.
- 2) All capacity releases start with an offer, however, some offers have pre-arranged replacement shippers and not all offers are subject to bidding.

Other Pertinent Standards:

WGQ Standard 5.3.1 The Capacity Release timeline is applicable to all parties involved in the Capacity Release process; however, it is only applicable if 1) all information provided by the parties to the transaction is valid and the acquiring shipper has been determined to be credit worthy before the capacity release bid is tendered and 2) there are no special terms or conditions of the release.

Commentary: If this standard is to remain unchanged, datasets need to be modified such that releasing shipper instructions can be communicated without reliance upon special terms and conditions.

WGQ Standard 5.3.3 For the capacity release business process timing model, only the following methodologies are required to be supported by capacity release service providers and provided to releasing shippers as choices from which they may select and, once chosen, should be used in determining the awards from the bid(s) submitted. They are: 1) highest rate, 2) net revenue and 3) present value. Other choices of bid evaluation methodology (including other releasing shipper defined evaluation methodologies) can be accorded similar timeline evaluation treatment at the discretion of the capacity release service provider. However, the capacity release service provider is not required to offer other choices or similar timeline treatment for other choices, nor, is the capacity release service provider held to the timeline should the releasing shipper elect another method of evaluation.

Commentary: If this standard is to remain unchanged, the releasing shipper may need to provide the capacity release facilitator a means to pre-determine/valuate the value of the rate component for the net revenue and present value calculations for the purpose of capacity allocation. Alternatives are to restrict the types of acceptable bids if either net revenue or net present value is chosen (see example in clarification 7.3.14)

WGQ Standard 5.3.5 Transportation service providers should support volumetric releases with volumetric commitments by fully accounting for volumetric and reservation components, consistent with the rules and regulations enunciated by the Commission.

Commentary: Index-based capacity releases can performed on a volumetric or reservation basis. The formula may not be clear as stated so it is necessary to inform the TSP as a part of the offer.

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Proposed WGQ Standard 5.3.x1

For indexed-based capacity release offers, the releasing shipper should specify whether the index-based formula detailed in the capacity release offer should be applied on a volumetric or reservation basis.

WGQ Standard 5.3.27 For purposes of bidding and awarding, maximum/minimum rates specified by the releasing shipper should include the tariff reservation rate and all demand surcharges, as a total number or as stated separately.

Commentary: The example provided by ElPaso at the August 30-31, 2007 meetings may not appear to be consistent with this format because of the inclusion of commodity results but it was not a biddable offer. Even so, if the releasing shipper states that the formula is to be applied against the reservation charge and ElPaso bills for its commodity charges then the formula is consistent with 5.3.27. The BPS should discuss whether 5.3.27 should be modified to include all components for index based releases or to require the releasing shipper to specify whether non-reservation components are in the formula. Alternatively, if the concept of formulas is added to 5.3.27, then index based release formulas would comply with 5.3.27 on the presumption that bidders would take the non-reservation components into consideration when making their bids.

Modified Redline Version of WGQ Standard 5.3.26 [from 9/9-10/07 BPS Meeting].

The releasing shipper should have choice to specify which of the following methods is acceptable for bidding on a given capacity release offer:

- dollars and cents,
- ~~or~~ percents percentage of maximum tariff rate, or
- index-based formula as detailed in the capacity release offer. ~~in the denomination of bids and all transportation service providers should support this.~~

The bids for the given capacity release offer should adhere to the method specified. ~~Once the choice is made by the releasing shipper, the bids should comport with the choice.~~

The bidder may bid the maximum tariff rate, if one is so stated in the Transportation Service Provider's tariff or general terms and conditions, as an alternative to the method specified by the releasing shipper.

Modified Clean Version of WGQ Standard 5.3.26 [from 9/18-19/07 BPS Meeting].

The releasing shipper should specify which one of the following methods is acceptable for bidding on a given capacity release offer:

- dollars and cents,
- percentage of maximum tariff rate, or
- index-based- formula as detailed in the capacity release offer.

The bids for the given capacity release offer should adhere to the method specified by the releasing shipper.

The bidder may bid the maximum tariff rate, if one is so stated in the Transportation Service Provider's tariff or general terms and conditions, as an alternative to the method specified by the releasing shipper.

Commentary: As drafted, this should be interpreted that the bidder has to accept the formula provided by the releasing shipper as the basis for bidding. It is unclear whether

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index-based bidding should be as a percentage of the formula or a dollars and cents differential from the formula.

Proposed WGQ Standard 5.3.x2 (note: alternate proposal presented later in workpaper)

For indexed-based capacity release offers, the releasing shipper should specify whether bids upon the index-based formula detailed in the capacity release offer should be as a percentage of the formula or as a dollars and cents differential from the formula.

Proposed WGQ Standard 5.3.x3

For indexed-based capacity release offers, the releasing shipper should specify whether the index-based formula detailed in the capacity release offer should be applied on a daily or monthly basis.

Applicable Maximum/Minimum Rates:

Where tariff recourse rates exist and the capacity release offer pertains to a service agreement at recourse or discounted recourse rates, the process of determining boundaries on an index-based release rate is straight-forward as applied to a monthly reservation rate. Where service agreements with negotiated rates or market based rates may exceed the recourse rate¹, the maximum applicable rate for release purposes is the contracted rate paid by the releasing shipper. Index-based rates add another wrinkle because a formula could be specified where the monthly reservation rate was computed as an average of daily index prices. On any given day, the formula might exceed the daily maximum recourse rate (as calculated by Standard 5.3.22) but since the result of the formula is a monthly rate, this presents no maximum rate issue unless the result exceeded the maximum monthly recourse or contract rate, as applicable, in which case the release rate calculation and credit would be capped. Such logic could apply throughout the term of the release, i.e. daily calculated credits from a prior month could be applied to compute the reservation rate applicable in a subsequent month, however no calculated monthly reservation rate credit during the term of the release could exceed the applicable maximum monthly rate. On the other hand, if the releasing shipper specified that rates be applied on a volumetric basis and the result of the formula exceeded the maximum daily recourse or contract rate (as calculated by Standard 5.3.22), as applicable, the daily capacity release rate calculation and credit would be capped.

For clarity, the following standards should be considered:

Proposed WGQ Standard 5.3.x4

For monthly reservation indexed-based capacity release offers where the formula detailed in the capacity release offer requires calculations on a daily basis, while the daily results of such calculations may exceed the applicable daily maximum rate as calculated by WGQ Standard No. 5.3.22, any resulting monthly reservation rate may not exceed the applicable maximum monthly reservation rate.

Proposed WGQ Standard 5.3.x5

For volumetric indexed-based capacity release offers where result of the formula detailed in the capacity release exceeds the applicable daily maximum rate as calculated by WGQ Standard No.

¹ It is not certain that a recourse rate even exists in some cases of market based rates.

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5.3.22, the capacity release credit calculated for that day may not exceed that which would be calculated using the applicable maximum daily reservation rate.

Bidding and Awarding Capacity - Maximum/Minimum Rate Considerations:

Some index based released formulas may lead to a dollars and cents result when the capacity is awarded depending upon the published price indices used in the formula. Others will have formulas where the price of the capacity is not determined until the day before gas flows. In either of these cases, it appears most likely that bidders will not know the results of the formula during the bidding process. As such, it's possible that bids would be submitted that end up below minimum or above maximum applicable rates.

In the case of bidding based upon a dollars and cents differential from the formula, bids with a differential greater than the difference between the maximum and minimum rates should be evaluated as bids at maximum or minimum rate, respectively. In a rate cap environment, bids exceeding this difference are meaningless. For example, suppose maximum rate is \$3.00. If Party A bids formula plus \$4.00 and Party B bids formula plus \$5.00, neither has any risk of paying more than \$3.00. Further, what risk is there to Party A in replying to Party B's bid by bidding formula plus \$6.00 and so forth?

One might respond that either Party A or Party B should end the bidding war by placing a bid at the maximum rate as provided for in the proposed revised WGQ Standard 5.3.26 [from 9/18-19/07 BPS Meeting]. Even so, there is potential for unknowing bids above maximum rate, i.e. once the index values are known, the bid (or bids) is above maximum rate.

Comparable issues exist for percentage based bidding, i.e. bidding wars and a question of whether a bid at 150% of formula, for example, is below or above maximum rate at the time of award determination.

If certain bids can be identified as equaling or exceeding maximum rate prior to the award and be treated as bids at maximum rate, existing means can be used to award capacity, particularly if a pre-arranged shipper wishing to bid maximum rate exists. Additionally, the releasing shipper should as a part of the offer or upon request of the capacity release facilitator prior to the initiation of bidding (or perhaps at least prior to the award) submit a means to value the formula. Within the offer, a proxy price could be specified or notice that the published index prices on the day of award will be used as a proxy for future values.

To provide some administrative structure to the bidding and capacity award process, the following standards should be considered:

Proposed WGQ Standard 5.3.x6

For indexed-based capacity release offers where the bids upon the formula detailed in the capacity release exceed applicable maximum rate or are below applicable minimum rate should

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be considered to be bids at applicable maximum rate or are below applicable minimum rate, respectively.

Proposed WGQ Standard 5.3.x7

For indexed-based capacity release offers, to facilitate the capacity award, the releasing shipper may provide a means to value the formula as a part of the offer. If no such means is provided, the capacity release facilitator may request such from the releasing shipper. If upon this request the releasing shipper does not respond, the capacity release facilitator may choose not to award capacity.

Bid/Award Scenarios:

EIPaso Example 1

((NGIBW (CA Southern Border, Socal) – IFBW (NWP Rocky Mts)) –
((TSP Fuel Percent * IFBW (NWP Rocky Mts)) +
TSP commodity charge +
TSP commodity surcharge)) *100%

Further presume:

Maximum Tariff Rate = \$3.000, Minimum Tariff Rate = \$0.000

Release Term = One Month

No pre-arranged replacement shipper

Release Quantity = 5000 Dth/day

The releasing shipper informs the TSP that

- 1) release rate is a reservation rate (applied on a monthly basis)
- 2) bids should be as a dollars and cents differential
- 3) capacity should be awarded based upon the highest rate

Commentary:

In Example 1, the formula appears to be one that will result in a known dollars and cents number prior to gas flow but not necessarily prior to the conclusion of bidding. For a highest rate/dollars and cent differential scenario, the bids would be in the format of:

Formula +/- \$n.nnnn

It is simple to compare the bids and rank them, however, maximum and minimum rates need to be considered. Suppose the following bids were:

<u>Bidder</u>	<u>Quantity</u>	<u>Bid</u>
Party A	3000 Dth	Formula + \$ 3.0000
Party B	3000 Dth	Formula + \$ 2.0000

Highest rate would award 3000 Dth to Party A and 2000 Dth to Party B, however, El Paso provided the following in its presentation:

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Parameters:

NGIBW (CA Southern Border, Socal) = \$5.49

IFBW (NWP Rocky Mts) = \$3.71

TSP Fuel Percent * IFBW (NWP Rocky Mts) = 1.2% * \$3.71 = \$0.445

TSP commodity charge = \$0.25

TSP commodity surcharge = \$0.05

Calculation $(\$5.49 - \$3.71) - (\$0.445 + \$0.25 + \$0.05) = \1.035

Plugging the index formula calculation result into the bid:

Bidder	Quantity	Bid
Party A	3000 Dth	$\$1.0350 + \$ 3.0000 = \$ 4.0350$
Party B	3000 Dth	$\$1.0350 + \$ 2.0000 = \$ 3.0350$

Since both rates exceed the maximum rate of \$3.0000 and neither shipper could pay more, highest rate would be unfair to Party B. Using proposed 5.3.x6, the award would be 2500 Dth to Party A and 2500 Dth to Party B.

Using the same example above but presume the offer specifies bids on a percentage basis and the bids come in as follows:

Bidder	Quantity	Bid
Party A	3000 Dth	350% of Formula
Party B	3000 Dth	300% of Formula

Highest rate would award 3000 Dth to Party A and 2000 Dth to Party B, however, plugging the index formula calculation result into the bid:

Bidder	Quantity	Bid
Party A	3000 Dth	$350\% * \$1.0350 = \$ 3.6750$
Party B	3000 Dth	$300\% * \$1.0350 = \$ 3.1500$

Since both rates exceed the maximum rate of \$3.0000 and neither shipper could pay more, highest rate would be unfair to Party B. Using proposed 5.3.x6, the award would be 2500 Dth to Party A and 2500 Dth to Party B.

In this case, the index formula result is known at the time of award but in many cases, the result will not be known. Lack of knowledge may not make the results fairer thus having a means to valuate the formula would on some cases be of value to the capacity release facilitator as well as to the bidders.

With reference to the Net Revenue and Net Present Value examples in Interpretation 7.3.14, bid comparison, particularly where bid quantities and formula results vary from month-to-month present challenges to the award process.

Special Note on Percentage Bidding for Index Based Release Formulas

The example above presumes that bidding is a percentage upon the offer formula, however, the releasing shipper may want the percentage applied only to a component of the formula, for example, to create a floor price. Modifying ElPaso Example 1 slightly demonstrates this point:

ElPaso Example 1 - modified

$$\begin{aligned} &(((\text{NGIBW (CA Southern Border, Socal)} - \text{IFBW (NWP Rocky Mts)}) - \\ &((\text{TSP Fuel Percent} * \text{IFBW (NWP Rocky Mts)})) * 100\% + \\ &\text{TSP commodity charge} + \\ &\text{TSP commodity surcharge} \end{aligned}$$

Further presume:

Maximum Tariff Rate = \$3.000, Minimum Tariff Rate = \$0.000
Release Term = One Month
No pre-arranged replacement shipper
Release Quantity = 5000 Dth/day

The releasing shipper informs the TSP that

- 1) release rate is a reservation rate (applied on a monthly basis)
- 2) bids should be as a percent of the non-TSP commodity portion of the formula
- 3) capacity should be awarded based upon the highest rate

Parameters:

NGIBW (CA Southern Border, Socal) = \$5.49
IFBW (NWP Rocky Mts) = \$3.71
TSP Fuel Percent * IFBW (NWP Rocky Mts) = 1.2% * \$3.71 = \$0.445
TSP commodity charge = \$0.25
TSP commodity surcharge = \$0.05

Calculation $(\$5.49 - \$3.71 - \$0.445) + \$0.25 + \$0.05 = \1.035
Formula Component = $(\$5.49 - \$3.71 - \$0.445) = \0.735

Presume the bids come in as follows:

<u>Bidder</u>	<u>Quantity</u>	<u>Bid</u>
Party A	3000 Dth	350% of Formula Component
Party B	3000 Dth	300% of Formula Component

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Which equate to:

Bidder	Quantity	Bid
Party A	3000 Dth	$350\% * \$0.7350 + \$0.3000 = \$ 2.8725$
Party B	3000 Dth	$300\% * \$0.7350 + \$0.3000 = \$ 2.5050$

Highest rate would award 3000 Dth to Party A and 2000 Dth to Party B.

It is not clear whether proposed revised WGQ Standard 5.3.26 [from 9/18-19/07 BPS Meeting] contemplates both Percentage Formula bidding and Percent Component bidding.

Alternate Proposed WGQ Standard 5.3.x2

For indexed-based capacity release offers, the releasing shipper should specify whether bids upon the index-based formula detailed in the capacity release offer should be as a percentage of the formula, percentage of formula component or as a dollars and cents differential from the formula.